Research

11
November
2020

CROSS ASSET
Investment Strategy

CIO VIEWS

Bonds are the sentinels in the sequence of recovery

THIS MONTH'S TOPIC

Addressing the legacy of the crisis in the emerging markets: the right policy mix in an uneven recovery

Confidence must be earned

Amundi ASSET MANAGEMENT

#11 - November 2020

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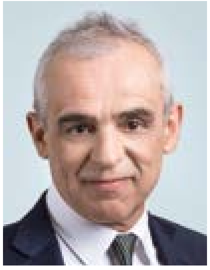
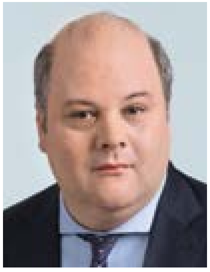
CIO VIEWS

Bonds are the sentinels in the sequence of recovery



PASCAL BLANQUÉ
Group Chief Investment Officer



VINCENT MORTIER
Deputy Group Chief Investment Officer

Developments on the virus and vaccine front and the US election are hot topics. **Markets are pricing in a glass-half-full scenario, despite the still-alarming infection numbers on the virus front** (second wave in Europe and record new cases globally). The interconnection of the three cycles — virus, real economy and financial — continues, but the virus transmission mechanism is changing. The ability of the virus cycle, which is the most critical of the three cycles, to affect the other two is now lower vs the beginning of the year. Today, the world is better equipped with regard to testing and local containment measures and therefore the likelihood of a global lockdown hurting the economy decreases. On the market side, the narrative that fiscal and monetary pushes will continue is preventing any major disruption. Any sign of weakness is viewed to be a buying opportunity.

Phase 1 of the recovery, with virus acceleration: this is where we are today. Any news regarding the trajectory of the recovery is good, but the end of the virus cycle is not yet on the horizon. The positive environment persists based on the strong assumptions of low rates forever and no inflationary pressure. It is true that the sequence in the coming months could be deflationary to begin with, but recovery is under way, thanks especially to China (and other Asian economies) that is further reinforcing its role as the global growth engine. Within this backdrop, equity, credit and Euro peripheral debt markets are responding well. However, in government bonds, volatility has been rising. While the anticipated curve-steepening has started, it is on hold for now. The elections outcome is unclear, and a massive fiscal stimulus seems unlikely.

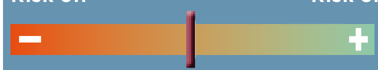
Phase 2: things have to get worse before they get better, and this means there are aggressive policies to come, especially on the monetary side. This bodes well for a recovery that should further support a rotation towards cyclical themes in 2021. This should favour equities, which could have more upside potential vs HY credit, which could be less appealing on a risk/return basis at current valuations. A rotation from super-high-growth stocks into more cyclical and quality value areas will likely materialise through in 2021, although this trend seems on a pause now. Commodity-related trades could also benefit from this cyclical rebound. **The availability of a vaccine would be part of this recovery: markets are pricing in availability in mid-2021 and then an economic reacceleration**. Any delay could generate volatility, putting the virus cycle once again at the top of market concerns. Investors should look at opportunities from rotation, while also being mindful of possibly higher volatility. **Bonds will be the key sentinels for the next phase**.

Phase 3: from improving to sustained growth. The next part of the sequence embeds a new round of policy mix and a slow exit from the extreme accommodation seen so far. The measures introduced to fight the pandemic will be very difficult to withdraw, and governments and CBs will probably have to do more. Fiscal and monetary policies will be even more intertwined, making the possibility of further debt-monetisation to finance the recovery a likely scenario. Some EM with weak CB credibility could see inflation rise faster amid their recoveries which could trigger higher commodity prices. This might overheat the economy, ultimately leading to some inflation. This could de-anchor the system, which is based on the assumption of low rates forever, and real rates could become more volatile. This phase will be challenging for risk assets and could favour further rotation into equity value, commodities and real assets.

The switch from one phase to another will not be linear and investors must keep in mind both short- and long-term themes. While on a pause now, with uncertainty linked to the US election, next year, the switch from phase 1 to phase 2 will bring rotation opportunities (equity in EM and the more cyclical quality and value spaces), but investors should focus on diversification and selection to counteract volatility. Over the long term, all three phases incorporate some common themes that will be reinforced by the crisis: higher debt, higher inequalities, and a stronger role for China in global trade and economic growth. From an investment perspective, quality and sustainability will once again be key factors to take into account. ESG themes, with a focus on social and green, will become mainstream. Diverging paths in economic growth will emerge. In EM, countries closely linked to China and with higher CB credibility to fight possible inflation surprises will be favoured while other, more indebted countries with fragilities could be challenged. This will make the concept of EM as a whole more outdated and lead to the emergence of global themes linked to the Chinese recovery and cyclical winners.

Overall risk sentiment

Risk off **Risk on**



With a prudent, diversified stance, exploit rotation in cyclical, quality value equities; opportunities in ESG

Changes vs. previous month

- Lock-in gains in assets with asymmetric risk profile
- Look for a rotation from low-quality credit to equity, amid expectations of higher earnings

Overall risk sentiment is a qualitative view of the overall risk assessment of the most recent global investment committee.

MACRO

A glittering environment for gold

MONICA DEFEND
Global Head of Research

LORENZO PORTELLI
Head of Cross Asset Research

We believe that the CNY and, most importantly, the unconventional monetary policy have taken a lead in explaining gold price dynamics

Gold prices have been rising since March as policymakers stepped in to support the global financial system affected by the Covid-19 crisis, although recently as the Fed paused its asset purchases, the metal witnessed some correction. Going forward, we believe gold prices will be supported by two main factors: **1) the renewed taxonomy of gold price determinants** (discussed later) envisages that CB balance sheet expansion and CNY dynamics would play a prominent role and **2) our conviction for the yellow metal has shifted from a 'pure hedge' to an 'asset class,'** with potential to gain in case of both the downside and the upside economic scenarios.

Over the past few years, we have discussed gold along the lines of its safe-haven nature in the face of increasing geopolitical risks even when rates were rising and in general amid risk-off events. More recently, the (inverse) relationship of gold prices with EMs' dollar funding and real rates has been progressively enforced. We expect to see further consolidation to higher levels, **with $2,100/ounce as a reference for fair value in our radar.**

We are still in the grip of the pandemic amid a deterioration of Covid-19-related news flow, which eventually points towards resilient gold prices. Our internal analysis and modelling shed more light on the drivers and sensitivities of the yellow metal, although it is important to note that there is no easy and comprehensive valuation matrix for gold. According to evidence, there are three broad determinants for the gold price:

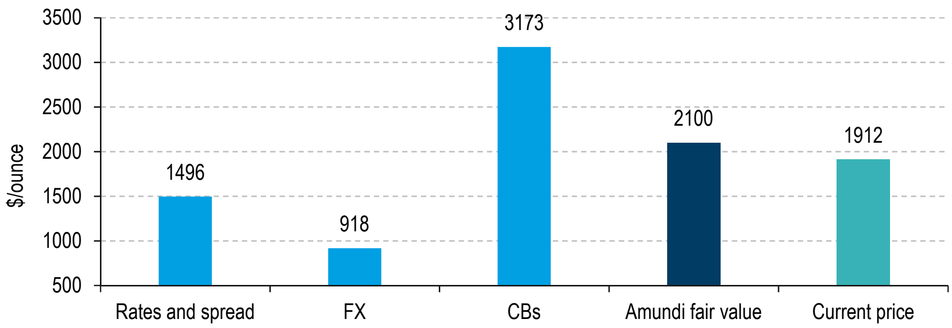
- Economic and real variables (i.e., GDP, inflation, real rates, spreads, among others);
- FX dynamics (USD, JPY and CNY in particular) ;
- Central banks' unconventional monetary policies (Fed, ECB and BoJ balance sheet expansion).

As per our calculations, there is a renewed taxonomy and **we are convinced that the CNY and, most importantly, the unconventional monetary policy have taken a lead in explaining gold price dynamics.**

This ultimately explains the increased correlation with equity prices through a common link – declining real rates that are a side effect of unconventional monetary policy. As we expect the economic recovery to be uneven — requiring active interventions from CBs if growth hits a roadblock or even falls off — and the Chinese economy to lead global growth (which should be reflected in a higher CNY), we believe there is room for gold prices to appreciate further. In the chart below, we show how the different key variables are likely to affect gold prices. Clearly, if CBs continue to maintain their asset purchase programmes and infuse liquidity into the system, it will have, by far, the strongest impact on prices which should rise to around $3,173/ounce. On FX, if we see a weaker USD and a stronger CNY, gold prices are likely to appreciate from current levels.

To conclude, as per our proprietary GREAT framework that measures the price sensitivity of an asset class to macro-risk factors, we expect gold prices to display symmetric price behaviour. **This means that in case of both upside and downside economic scenarios, the aforementioned categories/ determinants would positively affect gold prices**. In fact, should the upside materialise, inflation pressures will likely push real rates down, eventually boosting gold prices. On the other hand, in the downside scenario, we expect CBs to further expand their balance sheets and increase liquidity, likely supporting higher prices for the metal.

Different angles and fair value



Source: Amundi Research, Bloomberg on 19 October 2020. Amundi fair value is calculated by including rates and spread, FX and central bank (CB) metrics in a comprehensive model, whereas the first 3 histograms are based on mean reversion and specific angle assumptions.

*BoJ =Bank of Japan - *GREAT Framework: Global Risk Exposure Analysis Tool developed by Amundi.*

MULTI-ASSET

Remain conservative and monitor signs of rotations

MATTEO GERMANO
Head of Multi-Asset

We are close to neutral on equities and slightly positive on credit, but are monitoring whether an improving economy and vaccine availability provide better entry points

We see economic recovery as supported by policy initiatives, although there could be downside risks to Q4 growth. This recovery, coupled with vanishing base effects of energy prices, is likely to support inflation in DM. However, the task of generating inflation looks to be tougher in Europe than in the US, whereas in EM, supply shocks are generating pockets of inflation that need to be monitored. Another source of volatility may come from the US election outcome and a resurgence of the virus. **Thus, investors should remain vigilant and maintain an active stance.** However, when US political uncertainty subsides and there is more clarity on growth and a vaccine, investors may look to cautiously rotate from credit into equities.

High conviction ideas

We deliberately do not change our view on equities at the moment, maintaining a tactically close to neutral stance — defensive on the US (stretched IT valuations) and neutral on Europe. Recovery expectations in 2021, and attractive relative valuations and risk premia, point to an improved case for equities over a 12-month horizon, provided a vaccine becomes available in a timely manner and a surge in infections is controlled. Subsequently, cyclical segments could benefit from a rally. In the near term, higher beta plays, such as US small caps or EM equities, could offer some upside, but timing is crucial. We are constructive on Asia (China and Indonesia), owing to expectations of a more pronounced recovery in the region, higher earnings and better virus containment.

Investors should stay active in duration, with a close to neutral stance overall. In the US initial reports from the elections suggest Trump's performance will be better-than-expected by opinion polls. We are extremely vigilant on the likelihood that Trump holds onto the Senate. That could affect the extent to which the curve steepens. On US inflation, we maintain our constructive view amid the Fed's average inflation targeting, continuing economic recovery, and debt monetisation tendencies.

We are positive on Euro peripheral debt on the back of ECB support, favourable technicals and the positive impact of the EU Recovery Fund. We maintain our 5Y BTP position, which should benefit from political stability and suffer less in case of a bear steepening of EMU curves.

Although credit spreads have tightened considerably since March, **we remain neutral/ slightly positive for the time being** in light of the demand for carry and QE support. We favour EUR IG over US IG, due to the combination of attractive valuations, ECB purchasing programmes, and lower leverage in Europe than in the US. **Global liquidity and search for yield should benefit EM fixed income**. We maintain our positive stance in HC debt, but believe the room for further compression in local rates is limited, with the main driver being currency exposure. Overall, the EMBI spread is close to fair value, with the possibility of spread tightening in HY in the next three months. However, IG spreads now seem to have reached expensive levels. In FX, we remain positive but selective on a diversified basket of EM FX due to attractive valuations, light investor positioning (and rising flows), and potential support from economic recovery. However, investors should tactically hedge this exposure, given the US political uncertainty. On the other hand, the USD looks overvalued over a medium-term horizon and we may see a correction, as the country has lost its growth and high-real-rate advantage vs the rest of the G10 FX. But for the time being, it may be risky to be directionally negative on the greenback, as election volatility could support it. The GBP may be weighed down by the UK's weak economic activity, although Brexit news flow needs to be monitored.

Risks and hedging

The risks of weak economic growth and policy failure underscore the need to maintain appropriate hedges, to protect equity and credit exposure, in the form of derivatives, the yen and gold. The USD is also a good hedge, if global uncertainty rises.

Amundi Cross Asset Convictions

	1 month change	---	--	-	0	+	++	+++
Equities				□	■			
Credit						■		
Duration						■		
Oil					■			
Gold						■		

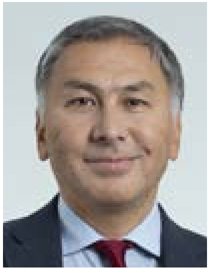
Source: Amundi. The table represents a cross-asset assessment on a 3- to 6-month horizon based on views expressed at the most recent global investment committee. The outlook, changes in outlook and opinions on the asset class assessment reflect the expected direction (+/-) and the strength of the conviction (+/++/+++). This assessment is subject to change. Equities view above reflects a neutral/close to neutral stance.

USD = US Dollar, JPY = Japanese yen, UST = US Treasury, DM = Developed markets, EM/GEM = Emerging markets, FX = Foreign exchange, FI = Fixed income, IG = Investment grade, HY = High yield, CHF = Swiss franc, NOK = Norwegian Krone, EUR = Euro, CBs = central banks, TIPS = Treasury Inflation-Protected Security, BTP = Italian government bonds, EMBI = EM Bonds Index.

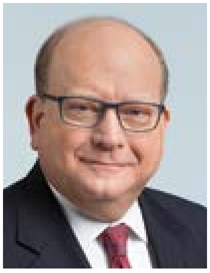
FIXED INCOME

Focus on carry and security selection in credit

ÉRIC BRARD
Head of Fixed Income



YERLAN SYZDYKOV
Global Head of Emerging Markets



KENNETH J. TAUBES
CIO of US Investment Management

In a low real rate environment, investors should balance the need to get higher yields with the need to buy quality credit at attractive valuations, all the while maintaining sufficient liquidity

We have witnessed a partial economic rebound in the US, but the extent of permanent job losses there must be watched, whereas leading indicators coming out of China are already above their pre-pandemic levels. However, in Europe, the situation seems to have deteriorated a bit due to a new wave of infections. Overall, we are not convinced that the economy is out of the woods yet. As a result, investors should note that the current crisis is all about avoiding traps and gaining exposure to sectors/names that favour an improving economy and a potential rotation. Having said that, we are cautious with respect to potential volatility related to the US political situation and Brexit risks, and, accordingly suggest maintaining ample liquidity.

Global and European fixed income

With a keen eye for relative value trades, we have an overall neutral duration view, positive in the US (hedge against weak global environment) and France, and cautious on Germany and the UK. Recently improved political sentiment on Euro peripheral countries has encouraged us to remain positive on Italy and Spain. However, amid a new wave of infections which are causing renewed lockdowns, we are cautious on EZ inflation, despite cheap valuations. While we are constructive on credit, we acknowledge that investors face a dual challenge: buying cheap and buying quality credit. This is further complicated by continued central banks/fiscal backstops that will provide easy liquidity, which in turn is causing some segments of the market to be overpriced. **This, coupled with a continuation of fragmentation, increases the scope for security selection in terms of sector and name**, with opportunities in financials and subordinated debt, but investors should maintain sufficient cash buffers. Overall, we prefer EUR to the US in IG and HY, due to the lower leverage.

US fixed income

The steepening of the US yield curve could see a pause in the short term, as the prospects of a massive stimulus have faded. We stay cautious on USTs. Markets are not pricing in medical improvements or a potential vaccine. On the Fed side, there is limited room available with respect to how much further low rates can fall from current levels (without overheating the economy), given that real rates are already low and there are already long/medium term prospects for inflation. **Therefore, we maintain our positive view on TIPS.** On corporate credit, we suggest investors pare back spread duration through active selection. They should also trim exposure to HY cash bonds where risks are asymmetric. On the consumer front, there were concerns that when government support measures expire, the economy would be hit hard. But consumer spending picked up and the housing market and consumer debt servicing remain strong. We see opportunities in securitised credit and consumer and residential mortgage markets, where we favour agency MBS over prime RMBS.

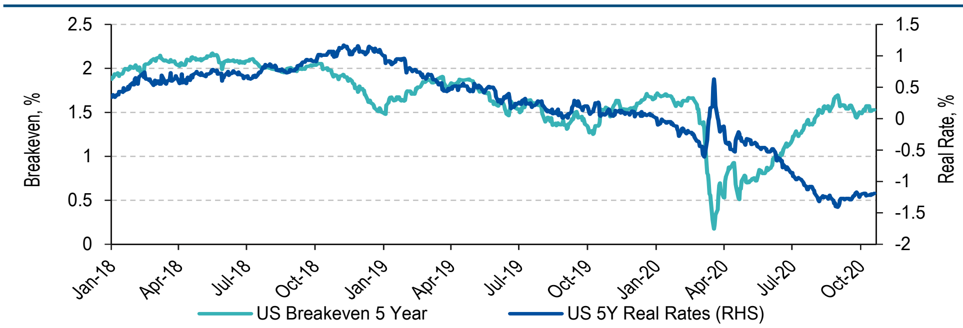
EM bonds

Dollar trends are the key element to watch. In such respect, the worst-case scenario is one of a persistent Dollar strengthening. EM central banks would have to deal with a dilemma between responding to the COVID-19 economic impact and stabilizing their FX and capital markets, leading to higher volatility in EM currencies. Some EM currencies, however, like the Russian Ruble, will show resilience and are likely to outperform in this environment.

FX

We are cautious on USD/JPY, positive NOK/EUR. The EUR would be weighed on the second wave infection in Europe.

US 5Y real rates and breakeven rate



Source: Amundi, Bloomberg at 21 October 2020. Breakeven = USGGBE05, Real rates = H15X5YR

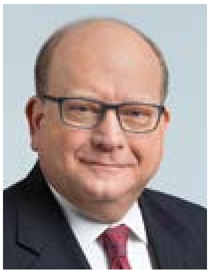
GFI= Global Fixed Income, GEMs/EM FX = Global emerging markets foreign exchange, HY = High yield, IG = Investment grade, EUR = Euro, USD = US dollar, UST = US Treasuries, RMBS = Residential mortgage-backed securities, ABS = Asset-backed securities, HC = Hard currency, LC = Local currency, TIPS = Treasury Inflation Protected Security, CRE = Commercial real estate, JPY = Japanese yen, CEE = Central and Eastern Europe, JBGs = Japanese government bonds, EZ = Eurozone.

EQUITY

Dispersion may create opportunities for selection

KASPER ELMGREEN
Head of Equities

YERLAN SYZDYKOV
Global Head of Emerging Markets



KENNETH J. TAUBES
CIO of US Investment Management

Overall assessment

Economic recovery is under way even if it is not uniform across the globe, as seen in the divergence in the services vs manufacturing sectors. Therefore, in addition to low forward visibility and a wide range of outcomes, investors will have to navigate a phase of imbalances not only in the form of high corporate debt, but also in the form of rising socio-economic inequalities. The current crisis has exacerbated these inequalities. Investors should navigate the current situation with an overall balanced stance.

European equities

While an uneven recovery will cause a high dispersion of returns, it also presents an opportune time for active selection. Valuation dispersion is high and we find great opportunities especially in the higher-quality area of cyclicals, but given the high level of uncertainty, selectivity is required. We have a strong preference for balance sheet strength and urge extreme caution in companies with weak balance sheets and those where business models are being disrupted. In addition, investors need to be careful of areas of excessive valuation, such as technology.

So, on the one hand, we remain positive on healthcare (slightly less so than before) within defensives, but at the other end of the barbell**, we find opportunities in cyclical compartments,** such as building materials, that are a good way to play the recovery. We also increasingly find attractive names in consumer discretionary, where the risk/reward has been compelling, though one has to be very selective. Overall, we maintain a balanced approach. Another interesting strategy is value, as it could benefit from reflation expectations moving into 2021.

US equities

The uncertain US election outcome, with a likely divided Congress should prevent any major fiscal stimulus. This could pause the reflation trade and the cyclical call. The later will only be postponed until when a vaccine is available and the economy accelerates.

Even in the case of a Biden victory with a divided congress, we don't expect any major legislation against the tech sector, that will remain well sustained, in the wake of Covid 19 pandemic.

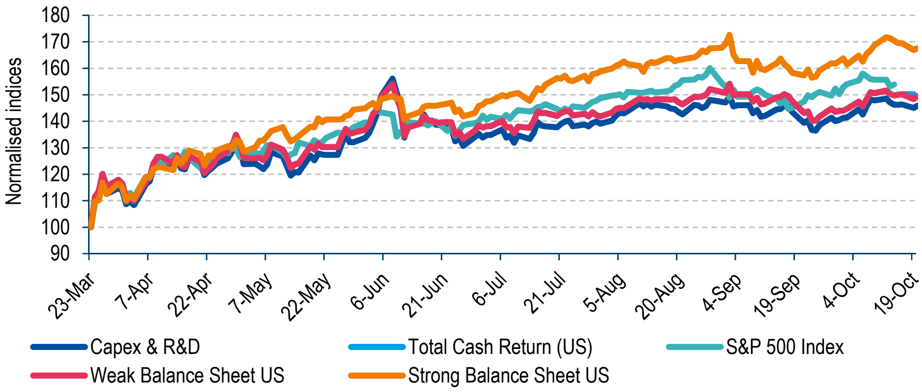
We like **selected quality value stocks** that can manage through this difficult economic period and should benefit as the US and global economies rebound and as inflation returns. However, **there is uncertainty over the timing of reflation** and the potential for a corresponding increase in rates. In addition, certain value-oriented sectors (airlines) are structurally impaired.**.** On the other end of the spectrum, we are constructive on stable growth names, exposed to secular growth trends that are not dependent on economic growth: eg, the shift to online retail. In contrast, we are cautious on hyper-growth and deep value.

EM equities

While a recovery should support EM, US-China tensions must be watched. In Asia, we are optimistic on countries such as South Korea (first-in, first-out). At sector level, semiconductors look appealing whereas high valuations in healthcare and consumer staples make us cautious. Investors should selectively explore cheap names in growth/value, with a focus on those offering sustainable dividend yields or growth catalysts.

The subdued recovery under way could favour a rotation towards cyclical names, but stock selection is critical to identifying resilient businesses with the potential for sustainable returns

US stocks with strong balance sheets outperformed



Source: Amundi, Bloomberg on 21 October 2020. Goldman Sachs indices rebased to 100 on 23 March 2020

THEMATIC

DIDIER BOROWSKI
Head of Global Views

PIERRE BLANCHET
Head of Investment Intelligence

The alphabet is not enough to picture the recovery

Write hard and clear about what hurts*

Economists have frequently used the alphabet to characterize the profile of the recovery. But one letter does not fit all. It is the duration of the epidemic which will ultimately determine the shape of the recovery. The desynchronisation of cycles should open the door to traditional geographic diversification.

Which profile for the recovery: U, V, W, L, K? What else?

Economists have frequently used the (Latin) alphabet to characterize the profile of the post-Covid-19 recovery. The letters V, U, L, W and, more recently, K have been (and still are) widely used, often without specifying the horizon of the analysis or the underlying assumptions on the duration of the epidemic, and in any case without discriminating between economic variables (are we talking about GDP, GDP per capita or employment?).

Let's try to clarify. In terms of GDP, V characterizes the recovery in China rather well, and more generally in North Asian economies. U (the shape of a bowl) aims to characterize a slow recovery (as opposed to V), which does not allow for a rapid return to pre-crisis GDP levels. The W refers to the possibility of a "double dip" generated by a second wave. L indicates a definitive loss of potential output. Some also referred to the square root (i.e. a long plateau for GDP after the technical rebound observed in Q3), or even – in a more poetic way – to a "bird's wing" recovery profile. Finally, a K shape designates a recovery characterized by a (definitive?) increase in existing fragmentations: an increase in inequalities and lasting sectoral divergences.

The problem with K…

More precisely, K is meant to highlight diverging trends among regions, countries, and sectors where some are recovering and even thriving while others are not and might even collapse. This can be a temporary pattern of the post-Covid-19 world, with severe consequences for financial markets. In fact, there is a big difference between lagging and diverging, with little hope of catching up.

For decades, the global business cycle has evolved through lags and leads among Europe, Asia and the US. However, regions and sectors are linked with one another, and so are fiscal and monetary policies and financial markets. A K-shaped scenario is a very different story, as prolonged diverging nominal growth paths could break the link between international business cycles. This would eventually mean diverging market behaviours with a particular impact on bonds and foreign exchange.

A second important aspect of a K-shaped scenario is that *winners take all*. Since capital flows into higher growing segments, without policies to rebalance it, financial bubbles and misallocation of resources are likely over the long run. A prolonged K is a risk, as it cannot be a sustainable scenario since it is suboptimal from a policy standpoint to witness without acting. Yet, sharp but temporary divergences described by the K letter will make factor investing strategies less efficient, and investors will come back to classic geographical allocation strategies.

One letter does not fit all

The Covid-19 crisis will leave scars that are all the more lasting and deep in the economy as the epidemic will last for a long time. There is empirical evidence that epidemics with a high mortality rate have a direct impact on potential growth (due to the demographic shock) and little impact on inequalities. Conversely, a "mild epidemic" such as the Covid-19 – which has a low fatality rate compared with past epidemics – has no impact on demography but tends to increase inequalities, which may indirectly weigh on potential growth. It is the duration of the epidemic (which is an exogenous variable) that will ultimately determine the shape of the recovery, and the alphabet letters can be misleading. Our working hypothesis is that no vaccine and/or treatment will be available before H2 2021, which leaves the door wide open to an erratic growth profile in the short term and ultimately tends to confirm our central scenario of a slow, uneven and multi-speed recovery depending on the country and sector.

Finalised on 23/10/2020

* *Ernest Hemingway*

THIS MONTH'S TOPIC

Addressing the legacy of the crisis in the EM: the right policy mix in an uneven recovery

The duration of the epidemic will ultimately determine the shape of recovery. An uneven recovery and subdued inflation (barring any persistent supply shock) will call for a prolonged accommodative policy mix, in either monetary or fiscal policy. The merger of the two has to be careful monitored in emerging markets.

ALESSIA BERARDI
Head of Emerging Markets Macro and Strategy Research

The pandemic is far from being under control and we are witnessing new outbreaks or second phases across many countries followed by local and targeted lockdowns

Benign inflation picture with temporary spikes due to supply disruption and food exports bans in place due to the pandemic

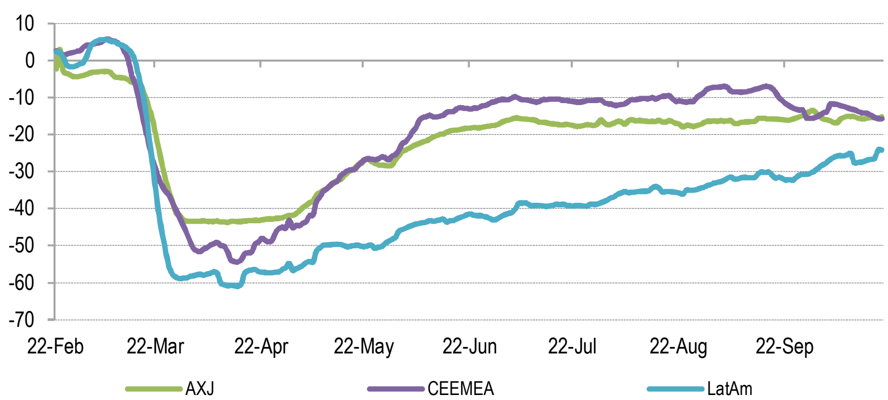
The current pandemic has hit all emerging economies without distinction, with the apex felt during the first half of 2020. Having said that, the depth of the scars it left has been different from country to country. Across the regions, Eastern Europe and CEE3 (Hungary, Poland and Czech) in particular have proven to be the most resilient, as well as North Asia (China, Taiwan and South Korea). Within Asia, it's worth highlighting the remarkable differences between South and North, with northern countries managing the pandemic and reopening more effectively than the southern countries (India GDP fell by around 24% YoY in Q2 2020), which are still struggling to come out of the first wave.

Although economic conditions when everything began were not the healthiest possible, a return to the pre-crisis economic status is proving slower and more challenging than expected. The pandemic is far from being under control and we are witnessing new outbreaks or second phases across many countries followed by local and targeted lockdowns. Based on daily economic activity data, the robust rebound in place since the easing of the Great Lockdown has stabilised since August and then shifted downward in some countries. Economic activity has slowed down in countries where new targeted lockdowns have been enforced (e.g., in Indonesia, Malaysia and Israel) as well as in countries where the infection rate has temporarily increased above the recent average even in the absence of any new enforced restrictions (e.g. in South Korea in September).

Domestic as well as external demand have driven the current rebound. In the first phase of the crisis, rapidly available cash benefits or transfers have supported consumption in countries where wage subsidies were less effective, due the prominence of the informal sector. Sector-wise, the rebound has mainly concerned manufacturing while services have lagged behind. Tourism is one of the worst-affected sectors in this pandemic. There were zero international tourist arrivals in August for the fifth month in a row in Thailand, where tourism accounts for around 12% of GDP. On a more positive note and still on the external side, EM exports have rebounded robustly since June 2020. Although the recovery in exports has been broadly based, it is worth noting the vibrant tech production and export cycle that favours North Asia countries and generally the tech sector/ companies across the world. Earnings of the MSCI China Index, which has expanded the weighting of new economy companies since 2015-16, are more and more dependent on the EM exports cycle than on general world trade dynamics, highlighting the importance of regional integration.

With regard to inflation, a benign trajectory is underway and we expect only a gradual pick-up in 2021 vs 2020, due to the wider slack in the economy (which existed in part in some countries already before the crisis). The yearly smooth inflation figures could hide some more challenging and volatile dynamics along the year, certainly around Q2 2021, when a spike will be made possible by the very low base in Q2 2020 (driven by the oil price collapse). Provided that the inflation

1/ **Mobility data**



Source: Google Mobility data, Data as of 20 October

THIS MONTH'S TOPIC

The focus is shifting to unconventional space as conventional room has been mostly exhausted

Unconventional monetary policy conduct is made possible by a moderate inflation level, though in some cases it raises concerns about the monetary policy independence from fiscal policy

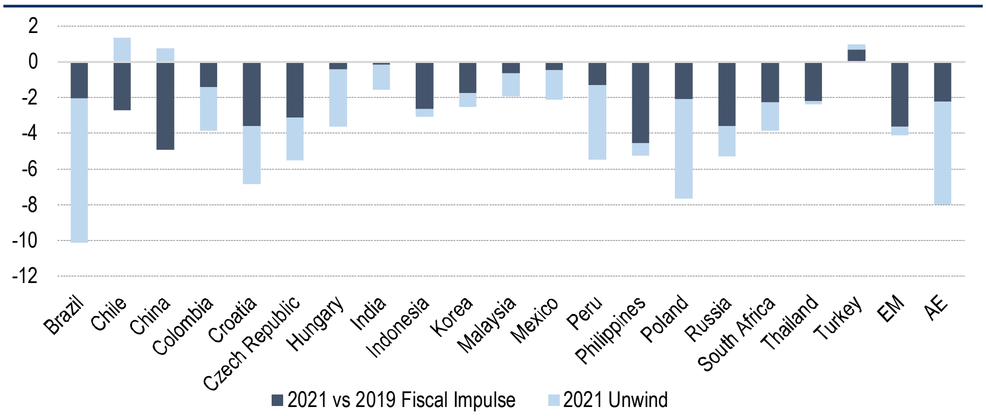
picture remains benign and, generally speaking, within or very close to the CBs targets, the recent mild pick-up reflects the importance of other non-core components in the price basket, as Food. The pandemic has produced a large amount of supply disruption (still difficult to quantify), as well as food export restrictions and this has been immediately reflected in high inflation in the emerging markets. One of the first reactions by many governments around the world was to guarantee adequate supplies of food, facilitating imports (through tariff reductions, streamlining of border procedures, and relaxation of labelling requirements), and/or restricting exports. The World Trade Organization (WTO) on June 18 prohibited members from banning food exports and several of these measures have subsequently been removed. Weak demand and supply disruption are mutually offsetting and though we envisage the first factor as dominant on the background, it's fair to say that the possibility of temporary spikes in inflation above the CB targets (different from the past inflation highs) can't be ruled out. Depending on the structure of the economy and efficiency in the price formation mechanism, these spikes could assume a less temporary shape, as has been happening in India, where inflation has remained above the quite wide RBI band for most of the year.

On the monetary policy front, the focus is shifting to unconventional space as conventional room has been mostly exhausted (with the exception of a few countries such as Mexico). Contrary to DMs, emerging market central banks will mostly use conventional and unconventional tools such as forward guidance (FG) or credit policies and QE in a non-monetary kind of way – mostly on the secondary market to manage and enhance liquidity especially during times of stress. The BCB, for instance, is squarely focused on FG and intends to use QE in the same fashion as its FX reserves. SARB is buying assets in small amounts to 'manage' liquidity only. On the other hand, the NBP and BCCh are buying assets in larger quantities and in a quasi-fiscal fashion, too – the former is purchasing state-backed debt, the latter bank assets. Unconventional MP conduct is made possible by a moderate inflation level, though in some cases it raises concerns about the monetary policy independence from fiscal policy.

In the latest couple of decades, emerging markets central banks have made significant efforts to make their monetary policy frameworks stronger and more credible. That was possible with the incremental use of the FG and with the effective adoption of a credible inflation targeting mandate, leaving the currency as the ultimate shock absorber as much as possible. Only in the recent years have the so-called "high Inflation countries" been able to bring back their Inflation rates back to acceptable levels, today mostly within the CBs' target ranges.

That said, enough is never enough for countries with structural issues and strong dependence on external demand and external financial flows. EM policy makers can't afford to be too complacent with what has already been done; they need to remain vigilant and the pandemic crisis is now raising doubts on the way the new policy tools are being adopted; although many EM central banks can legally buy government securities in the primary market, moving to quasi-fiscal or fiscal quantitative easing remains a last resort. An example of fiscal quantitative easing often reported is the burden-sharing scheme adopted by the Indonesia. The Bank of Indonesia is requested to buy in the primary market to fund the atypically high 2020 fiscal deficit. The process is announced as one-off and the way out officially recognised relies on the purchases targeted amount and on the fiscal consolidation strategy planned for the next few years (FD again below 3% by 2023 from the 6.3% in 2020). We do see the recently announced central bank law revision as background noise not impacting the planned monetary/fiscal strategy.

2/ **Fiscal impulse**



Source: IMF as of October 2020

THIS MONTH'S TOPIC

Moving to 2021, following the sharp increase of leverage in 2020, we expect to see slower accumulation of public debt in China

Notwithstanding the tentative fiscal consolidations announced, EM debt levels will take some time to stabilise and to reverse their upward trajectory

QE is not the only viable solution; in some countries, where inflation spikes can't be underestimated or inflation is already not at comfortable levels, central banks should only briefly indulge in unorthodox measures and focus rather on more efficient MP transmission and corporate debt restructuring challenges. The debt moratoria give some time to act until calm is restored but, sooner or later, the corporate debt issue has to be dealt with. In India, for example, it is paramount to reactivate the restructuring process to renegotiate debt through the bankruptcy code, in order for the banks to starting lending faster.

Although the pandemic crisis has had a global impact on both EMs and DMs equally, fiscal affordability considerations, including high borrowing costs, has been moderating the rush towards an aggressive fiscal policy stance in emerging markets, in comparison with developed markets. While we did see some divergences between DMs and EMs in terms of size and timing of execution of fiscal packages, the scope of the most urgent measures has been quite similar: support for the healthcare sector and households (via cash transfers and or job benefits). China has been an exception, and its fiscal deficit has expanded decisively in 2020; most of the funds raised thus far have been directed to infrastructure projects or to ease financing pressures in the corporate sector. The scale of public spending for households is relatively small compared to elsewhere. Moving to 2021, following the sharp increase of leverage in 2020, we expect to see slower accumulation of public debt in China. Although the fiscal deficit will not shrink immediately to pre-Covid levels, a moderate cut down is likely. We don't expect the RMB 1tn Special China Government Bond to be rolled over for another year. A reduction of local government bond issuance quota from RMB 3.75tn is also likely, which had been the main funding support for infrastructure projects.

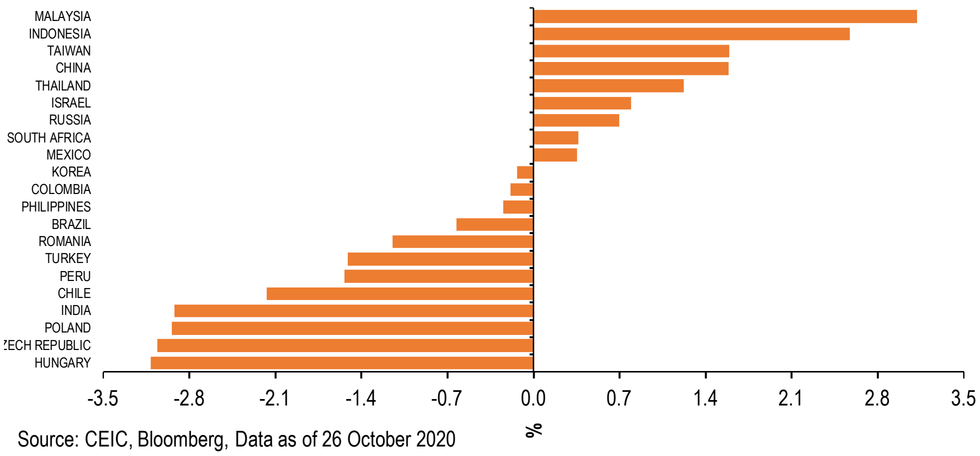
With regard to other EMs, the fiscal picture is quite diverse, despite the fact that a sort of fiscal consolidation is being pencilled in more or less in most of the 2021 budget laws so far announced and approved. On the one hand, there is Brazil, which constitutionally needs to unwind 9% of GDP of fiscal stimulus, and Mexico and Russia, where 2021 budget proposals were not short on prudence. Indonesia will also start renormalising fiscal balances as early as next year. In CEE, KOR, CHL/PER, meanwhile, room exists to cut back fiscal impulse gradually, while in South Africa the double-digit budget deficit will require politically challenging and socially painful cuts to public wages/employment and will therefore likely take some time to unwind.

Notwithstanding the tentative fiscal consolidations announced, EM debt levels (which increased far less than DM levels in 2020) will take some time to stabilise and to reverse their upward trajectory. The risk of an abrupt change in risk premia and, hence, a change in investor confidence (ratified by further rating agencies actions) needs to be carefully monitored. Credibility is as important for fiscal authorities as it is for monetary authorities.

Many low-income countries entered the crisis with already stressed fiscal positions and/or with a resources buffer just barely viable for serving the debt in normal circumstances and had to divert these resources to respond to the pandemic crisis. For these countries, the official sector, represented by the big supranational institutions, has recently agreed to extend the Debt Service Suspension Initiative by six months (till mid-2021) while a new framework is under discussion with the aim to make as more comparable as possible the many creditors involved.

Finalised on 23/10/2020

3/ EM real policy rates (current)



Source: CEIC, Bloomberg, Data as of 26 October 2020

THEMATIC

HY default cycle and rating changes: how it is "different" this time

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For the first time, no credit crunch in high yield markets took place, while a strong increase in refinancing activity left default rates a lowest rating/ sector story

Despite a severe macro contraction, policy reaction to the covid-crisis limited most of corporates' rating migration and HY defaults to low-rated debt. This piece outlines our expectations on both rating and default cycles to come.

A) The default cycle

1. Global HY default rates doubled in just a few months to their highest levels in the last decade

Global defaults mainly driven by US companies

Reflecting the credit effects of the coronavirus-induced recession and the stress already prevailing in the energy sector before the crisis, the global default rate of speculative grade companies has now peaked in relation to the last decade. According to Moody's, since the outbreak of the pandemic crisis, in just six months, the US HY default rate almost doubled, rising from a pre-covid level of 4.5% to 8.7% by the end of August, before subsiding to 8.5% in September. The European default rate has doubled also but from much lower starting levels: at just 1.7% in February, it rose to 3.4% in July and 3.9% in September: the gap between US and European default rates moved therefore from 2.8% in February to close to 5% in September.

So far, the global speculative-grade default cycle among advanced economies looks mostly like a US story and not just on a simple default rate basis: North America accounted for 117 defaults in the first nine months of the year while Europe accounted for 27. The dominant contribution of US companies to the rise in global defaults is evident and despite there being several reasons for this, they seem to be mainly due to a different sectoral exposure and rating mix.

Mainly a low-rated debt and sectoral story

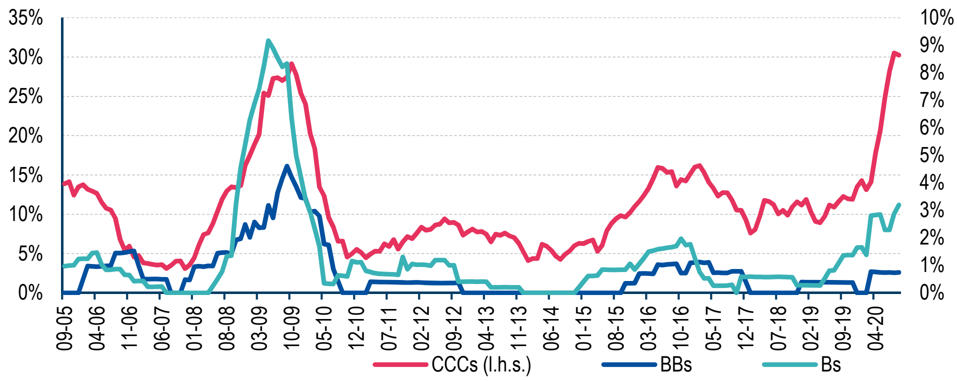
a. US defaults mostly driven by energy and retail...

Depressed oil prices created a challenging operating environment for the Oil & Gas sector, and specifically for Exploration & Production and Oilfield Service companies, the most sensitive to the sharp fall recorded in energy prices. In September, four other companies belonging to these business-models defaulted, bringing the entire sector's year-to-date total to 41. The other two sectors accounting for a large proportion of defaults in the US, and struggling more than others with business disruption related to the pandemic, are Retail with 21 defaults year to date, followed by Business Services, with 19 defaults. Moody's recently pointed out that the newcomers in the default cycle tend to be those sectors mostly impacted by disruptions produced by the pandemic crisis: *"In the coming year, we expect Business Services to have the largest number of defaults, followed by Hotel, Gaming & Leisure and Oil & Gas. As measured by default rates, however, Hotel, Gaming & Leisure will likely be the most troubled sector globally."*

b....and by a higher weighting of lower-rated debt

Broadening the analysis to the rating breakdown, the current crisis looks quite different from previous ones. At the time of writing, with default rates doubling seven full months into the crisis, the trend was almost entirely a CCC-rated story, as high and mid-rated companies still show very few bankruptcies, close to historical low levels. Interestingly, as chart 2) shows, current BB-rated and single B-rated default rates are at just 0.7% and 3.2% respectively, while CCC-rated default rates have already jumped to the highest levels of the GFC, close to 30%. Moody's assessment of this aspect shows that this dichotomy is likely to remain over

1/ US HY default rates, by rating



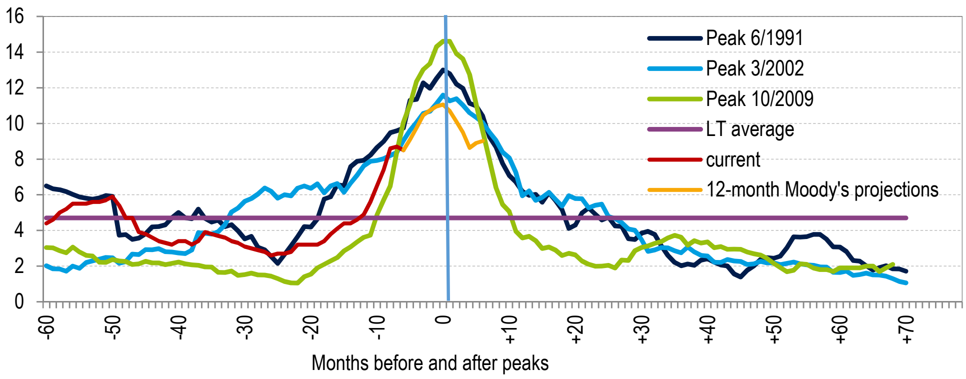
Source: BofA ML, Amundi Research - Data as of September 2020

It would be reasonable to assume that the default rates trend will be more uneven than in previous cycles

the next two years, when a macroeconomic rebound is expected, as *"the uneven economic recovery will likely be insufficient to save many of the weakest companies from default, especially those in the hardest hit sectors or those that were already struggling before the coronavirus."*

Extraordinary fiscal and monetary reaction to the crisis, both in the US and in Europe, limited its worst impacts to the most vulnerable companies rated speculative grade, mostly lower-rated and, for example, not benefiting like BBs from Fed intervention in favour of fallen angels. For the first time, no credit crunch in high yield markets took place, while a strong increase in refinancing activity left default rates a lowest rating/sector story. The Fed was quite effective in keeping defaults from rising through its unprecedented active approach, entering corporate purchases for the first time, and even giving support to fallen angels. In Europe, the combination of unprecedented fiscal measures especially through state guarantees, and all of the liquidity measures put in place by the ECB on the monetary policy side (through TLTROs initially) also proved to be quite effective in avoiding the credit crunch risk on bank loans, the key funding channel for European companies. The latter relied quite heavily on bank loan facilities and did not need to tap the bond market for substantial refinancing and to build cash buffers. Finally, the low yield environment is likely to temper defaults, too, especially among high and mid-rated companies.

2/ Previous three cycles of US HY default rates vs the current cycle with peak projected on last Moody's forecasts



Source: Moody's, Amundi Research - Data as of September 2020

2. Short-term prospects see a peak expected by Q1 2021, followed by lower defaults in Q2

Despite a pause in defaults over the last two months, driven by a lower number of defaulted issuers, rating agencies projections still point to a further, albeit limited, rise, especially in the US where Moody's foresees a peak close to 11% by Q1 next year. Projections for the European rate is for a lower peak at 5.6%, therefore with a wide gap remaining between the two areas. Moody's also mentions the indirect effect of ratings on its estimates: *"Our forecast of rising default rates through March 2021 is underpinned by the increased share of lower-rated companies in recent years and the downward rating momentum earlier this year following the pandemic-induced economic turmoil."* We address this important aspect of the current credit cycle in a later section. We share the view that a significant gap is likely to persist between the two areas over the next few months, as European speculative grade debt has much lower exposure to most of the troubled sectors (energy and sectors heavily hit by the pandemic crisis, such as retail and transportation) and a limited component of lowest rated debt vs the US. We also see Q1 2021 as the timing for the peak, as financial conditions and market-based leading indicators point to this outcome. Distress ratios in particular have rapidly fallen to low levels and they tend to lead defaults by between 9 to 12 months. In the reported chart, we compare the first phase of the current cycle, combining both the very first leg of actual defaults recorded with the next 12-months forecast by Moody's, with the previous three complete default cycles. The peak should be lower than in the past, mainly thanks to central bank intervention and fiscal stimulus, while the rise to the peak looks like it will be rapid and similar to the one recorded in the GFC. At the cost of potentially oversimplifying, we could say that monetary and fiscal interventions both seem behind the more rapid dynamic of GFC and (projected) current cycle, and that the lower peak expected next year has probably also to do with much higher volumes of stimulus vs the GFC.

3. What about a longer horizon?

In light of the unusual and to some extent artificial recovery in financial drivers of default rates, over a longer horizon, the risks of higher default rates mostly relate to challenging macro and micro trends on the one hand and the foreseeable reduction of current public support (for example, subsidies or loan guarantees) at some point in the future, on the other. On the macro

The actions of central bankers and politicians largely contributed to the slowdown in rating downgrades from May 2020

side, the degree of the slump and the time needed to regain pre-covid levels represent the main challenges. On the micro side, we would highlight the high level of leverage many companies entered the crisis with, the legacy of a few sectors that were already in some distress, the high proportion reached by BBB debt and the likelihood of persisting effects of the crisis in some sectors over the long run. In recent months, financial leverage has generally increased, because of the sharp fall in earnings and cash flows and the increased recourse to debt in order to build liquidity buffers and to match the sudden drop in revenues. Further down the road, for example, companies in the travel and leisure industry that have accessed funding in this phase will still face a challenging outlook to their business models via their capacity to regain pre-covid levels of activity. If the near-term outlook for defaults remains quite benign vis à vis the severity of the macro backdrop, the recovery phase is also unlikely to be normal. Although a second cycle of defaults looks unlikely, unless a new shock materialises and in light of vaccine developments, in the context of very elevated leverage levels, it would be reasonable to assume that the default rates trend will be more uneven. In other words, it could stay longer than previously in the mid-range levels during the recovery phase, rather than simply dropping to historical lows and stabilising as in previous cycles.

B) Rating changes driven by the crisis

1) Recent post-Covid trends

The rating agencies downgraded a record number of issuers and drastically revised down their economic growth forecasts following the lockdown measures taken worldwide in March 2020 to limit the spread of the Covid-19 virus.

Coordinated and unprecedented intervention by governments and central banks played a key role in this crisis. Central banks have created a safety net for bond markets, in particular for corporate debt, supporting the refunding of many companies and significantly limiting the number of defaults. Indeed, many companies have used the liquidity raised to increase their cash flow and extend the average maturity of their debt. This made a big difference during the 2008 crisis.

The actions of central bankers and politicians largely contributed to the slowdown in rating downgrades from May 2020. Indeed, the rate of downgrades fell from 10-20 per week versus more than 100 per week at the end of March, early April 2020.

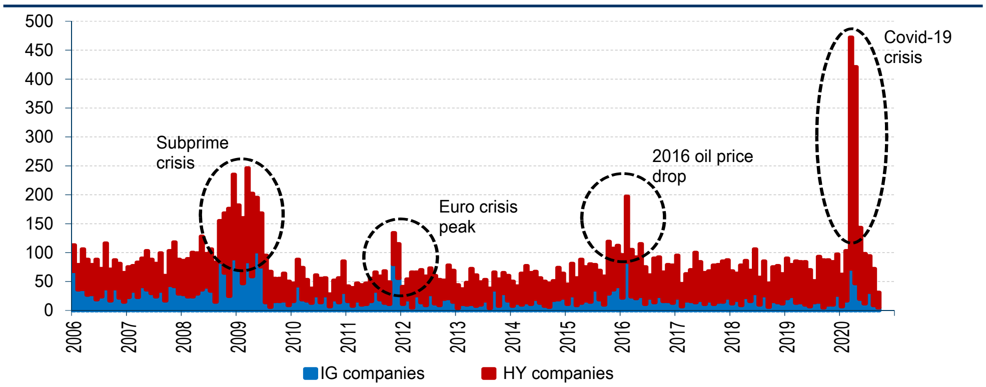
2) Details on ratings / sectors, most affected area

The number of rating downgrades for IG issuers remained limited, as these companies obtained more support from the central bank measures. **Fallen angels (companies moving from IG to HY) represented 28 issuers in total** in Europe and the US since the start of 2020. The existing cases correspond to the sectors most affected by the crisis: Energy (32% fallen angels), retail (14%) and travel (14%). **On the other hand, there have been numerous rating downgrades for High Yield companies.** These companies have a more fragile financial structure and are much more sensitive to a downturn in economic activity. As you can see in the graphs n°5 of the number of downgrades per year, there are many more downgrades for HY companies than for IG companies in 2020. Furthermore, we note that in terms of proportion in 2008 during the financial crisis, IG companies were downgraded more heavily than in 2020.

- In the US, HY issuers represent 85% of the total number of downgrades since the start of 2020.
- In Europe, on the other hand, there have been fewer downgrades of these issuers, which represent 68% of the total number of downgrades since the start of 2020.

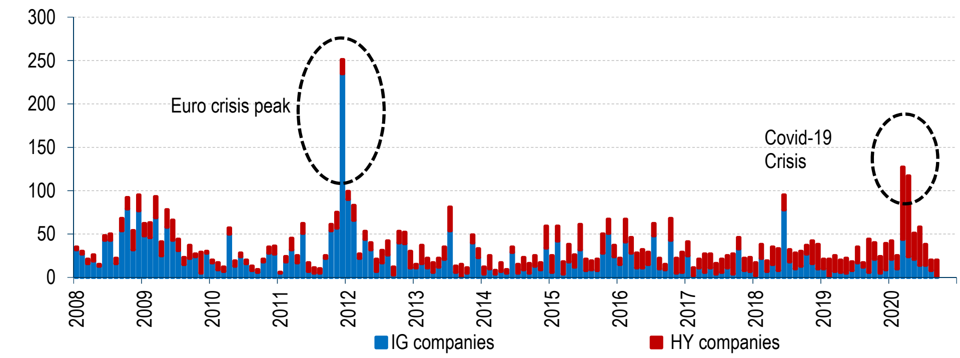
At the sector level, the deterioration is concentrated in the cyclical consumer sectors (30%) and more specifically media, entertainment, leisure and travel. These sectors are directly affected by the Covid-19 crisis. The energy and industrial sectors were also affected by this wave of deterioration.

3/ **US companies Nbr of negative rating actions S&P (Downgrade or CreditWatch negative placement)**



Source: S&P long term foreign rating, Bloomberg, Amundi Research, Data as of 14 September 2020

4/ Eurozone and UK companies Nbr of negative rating actions S&P (Downgrade or CreditWatch negative placement)



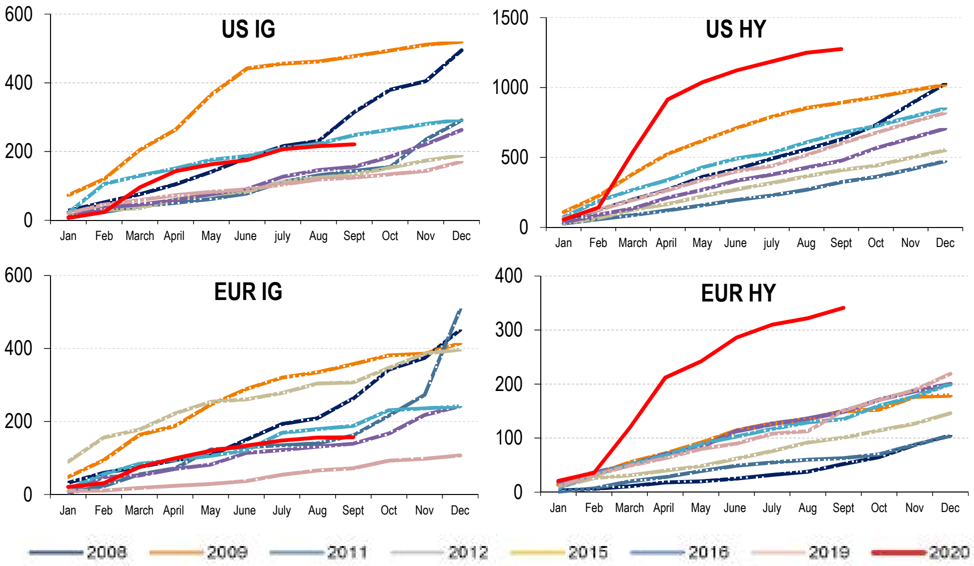
Source: Bloomberg, Amundi Research, Data as of 14 September 2020

The rating agencies are closely monitoring the evolution of (1) the health crisis and (2) the budgetary and monetary support measures put in place

3) What are the risks of a second wave of deterioration?

The rating agencies are closely monitoring the evolution of (1) the health crisis and (2) the budgetary and monetary support measures put in place. It is important to note that the rating agencies appear to be more accommodating towards companies with a high indebtedness level but which retain the capacity to generate cash flow. In fact, historically low interest rates allow companies to better sustain high levels of debt. Nevertheless, concerns remain around companies which have taken on debt to compensate for the decline in their activity and which have ultimately increased their debt.

5/ US and Eurozone+UK Companies cumulative number of negative rating actions by crisis period - S&P (Downgrade or CreditWatch negative placement)



Source: S&P long terme foreign rating,Bloomberg, Amundi Research, Data as of 14 September 2020

Conclusions

In a recession/crisis phase, default cycles are both a financial conditions story and a macro/micro story: unlike the past, these two stories have been showing diverging trends. Despite the fact that the expected economic slump (peak to trough) is far worse than during previous recessions and despite the long time needed to get back to starting GDP levels, the base case remains for a short-lived slump, thanks to extraordinary fiscal and monetary intervention. This short-term outlook seems to be confirmed by the trend in rating changes and by the fact that unprecedented stimulus reduced negative impacts on higher rated companies with respect to both the severity of the macro correction and past cycles. At the same time, the specific and global challenges for company leverage caused by the crisis and the time needed to recover may lead to more volatility than during past cycles in the phase when default rates fall from their peaks. In this respect, we believe that high quality and a focus on selection will make all the difference during the recovery phase also.

Finalised on 26/10/2020

THEMATIC

Bonds that are not really binding

PIERRE BLANCHET
Head of Investment Intelligence

Should the €2,800 billion in sovereign bonds or the equivalent* that are on the European Central Bank's balance sheet be treated just like any other bonds? This question, which has come up regularly over the past several months, is far from being of mere academic interest. In fact, it is symptomatic of a wish to forgive or even cancel a portion of the public debt being raised to cope with the Covid-19 crisis. But, rather than simply ignoring it, a more standard solution for the financial markets would be to regard such debt as virtual for the moment and to exclude it temporarily from public debt ratios.

Emergency spending, followed by economic support plans launched in 2020, has sent public debt up sharply, to worrisome levels in many euro-area countries. However, most of the newly issued bonds are being bought up by the ECB; the market is absorbing only a little more than usual[1]. Government borrowers and the ECB have said repeatedly that such debt cannot be cancelled and will one day be paid back. Moreover, this is in the public interest, as cancelling or restructuring some or all of this debt would devalue all European debt. Rather than simply ignoring the question or putting forth unrealistic solutions, it is worth asking how financial markets should treat it.

Do the characteristics of a financial asset change when it switches owners? From the strictly legal point of view, the obvious answer is no. Moreover, this is a fundamental principle that ensures equal treatment of bondholders, shareholders, creditors, etc. But **if the rights or obligations embedded in a financial instrument are never exercised, can they be considered as more virtual than real?** The financial markets often incorporate this parameter when the use that is made of an asset restricts *de facto* some of its characteristics.

Certain asset characteristics are possibilities that are never realised

Markets constantly adjust to reality

Take, for example, the number of a company's shares that are in free float calculation, which are often the only ones included in its weighting in market indices. The **company's own shares held in treasury are often excluded**, along with those held by pact-bound shareholders or by governments[2]. These shares exist, but they are regarded as not being freely traded on the market and are therefore left out of certain indices. This is the case, for example, of EDF, which is not in the CAC 40 index, even though its market cap exceeds €40 billion, as the French state holds 84% of its shares.

There is another type of exclusion involving the voting rights embedded with shares. As some shareholders don't vote at general meetings, a simple or qualified majority is necessarily different from a theoretical majority. In the case of most publicly traded companies, approval of the accounts or a major amendment to the articles of incorporation never require a theoretical majority. An average of just 70% of shareholders vote at general meetings[3]. Hence, a simple majority is reached with 35% of the votes and not 50%. **In fact, 30% of voting rights don't actually exist** except when a takeover bid requires that all rights be acquired. In the case of bond debt, the mechanism of forfeiture can be used to exclude bondholders who might be in a conflict of interests with others. This is a temporary exclusion of voting rights but a substantial change to the asset's characteristics. The accounting principles applying to consolidated debt or available assets also modify the characteristics of the liabilities arising from financial instruments, depending on the bondholder. The list is long and there are many such situations.

So, it can be seen that in daily practice on the financial markets, the nature of an asset's owner can temporarily modify an asset's characteristics in certain situations or in the way in which it is accounted. The right or obligation embedded with the asset then become possibilities that are never realised or that are realised only in extreme cases. **These are characteristics in potentiality but not in actuality.[4]**

Central Banks & Treasury special relationships

In the special case of European or US sovereign debt, an additional parameter must be included – the bond issuer and bondholder are of the same nature, i.e. public, not-for-profit institutions. The

* *As of the end of September €2,290bn under PSPP and €510bn under PEPP. Source: ECB: link*

[1] *Bertoncini, Sergio: Eurozone government bonds a supportive mix of remarkable funding progress and ECB QE still to come*

[2] *See, for example, the methodologies of the MSCI and S&P indices*

[3] *The rate is slightly higher for professional investors. In France for example, according to the French Asset Management Association (AFG) in 2019 "wealth managers exercised their voting rights for 78% of their shares in their portfolios". Rapport AFG 2019 Exercice des droits de vote par les sociétés de gestion*

[4] *Aristotle, Physics II*

The central bank has pledged to permanently refrain from selling its bonds

Excluding sovereign debt is virtual and temporary... but for a very long time

Federal Reserve's response to the US Treasury's issuance programme or the ECB's launch of the PEPP while euro zone governments are expanding public deficits substantially, demonstrate **close coordination and even conditionality between fiscal and monetary policy**[5]. Not to mention the monetisation of public debt, an implicit pact is binding the government debtor with its central bank creditor. The central bank **has pledged to permanently refrain from selling its bonds** on the market and, moreover, to participate systematically in refinancing maturing debt, unless justified by financial conditions.

The question naturally arises from the above examples: **does this debt held by the ECB or the Fed have the same characteristics as debt held on private investors' balance sheets? The answer is probably no.** For, if the bond issuer is certain that, over a horizon that surpasses the maturity of its issue, the bondholder will never sell it and will subscribe to a new issue upon maturity regardless of the price, it may rightly consider that this is not just any other bond. This is due to the central bank's clearly announced intention but is also to the institutional nature of the two entities. For, if the state is assumed to be eternal it can forego paying off its debt and instead refinance it, or roll it over. The central bank, meanwhile, can keep buying it forever as part of its monetary policy mandate.

The matter of legitimacy is even more pressing in the case of euro-area sovereign bonds, as the ECB's buying programmes are conducted essentially at the level of national central banks (the Eurosystem). Can the Banque de France sell a substantial amount of OATs without the French state's approval? Theoretically (in potentiality) yes, but in fact (in actuality) no. Meanwhile, when these bonds are issued at an interest rate of zero, there are no intermediate flows or ultimate value adjustments that would materialise the state's commitment. Moreover, for many countries, such as France, **the interest received and profits generated by the national central bank are passed on to the Treasury** in the form of taxes and to the government in the form of dividends[6]. So, what comes around, goes around. In fact, the bond's payment stipulation has been transferred into central bank money and is held by economic agents. Government debt becomes central bank debt owed to currency holders, a sort of perpetual, zero-coupon bond.

Change of paradigm

As is the case for other assets, the markets **should legitimately exclude sovereign debt that is on central bank balance sheets** from the calculation of state liabilities, as some of its characteristics have been altered for some time to come. Such an exclusion is as virtual as the debt is, and as temporary... but for a very long time. However, the currency issued by the central bank in exchange, is quite real. So, this matter should be approached less from the point of view of debt/GDP ratios or the equivalent, and more from the standpoint of the monetary base and monetary aggregates (M1, M2, M3 and L) and their counterparts (foreign debt, the state and the economy). Hence, non-conventional policies, when pushed to the extreme, can result in a new paradigm. They will force the **financial markets to switch analytical frameworks and return indirectly to monetary theory notions that had been somewhat cast aside.** There is even talk of a return to the 1970s[7].

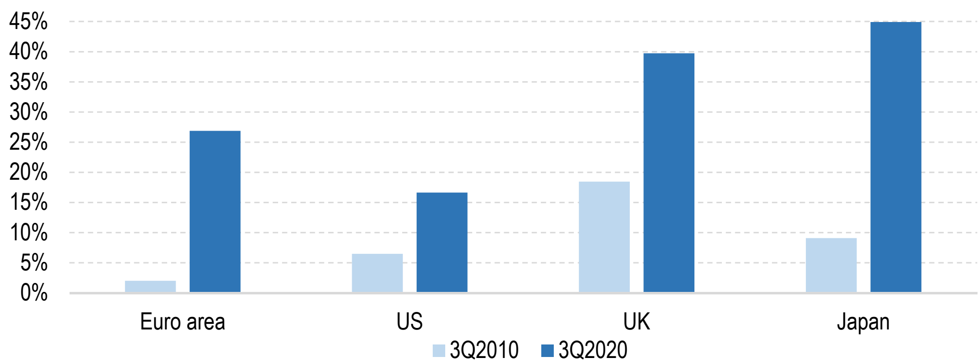
Finalised on 20/10/2020

[5] *See article "Should Central Banks Save us from Ourselves?", Amundi Research [link]*

[6] *Annual Report of the Bank of France, 2019, pages 110-112: €2,650 million in corporate income tax, and €3,478 million in dividends paid to the state. [link]*

[7] *Pascal Blanqué (2020), "Covid-19: the invisible hand pointing investors down the road to the '70s" Amundi [link]*

1/ **Change over 10 years of national holdings of sovereign debt (% total debt outstanding)**



Source: BIS, Fed, US Treasury, ECB, Eurostat, BoE, HMRC, BoJ, Amundi Research - Data as of 31 September 2020

CENTRAL & ALTERNATIVE SCENARIOS

Monthly update

This month, we amend the narrative of our central and downside scenario to take into account a larger than expected Covid second wave in Europe and delayed fiscal support in the US. We reduce the probability of our central scenario from 70% to 65% and increase the probability of the downside scenario from 20% to 25%,

DOWNSIDE SCENARIO 25%

Secular stagnation

Analysis

- Protracted economic downturn
- Due to uncertainty (lack of visibility), policy multipliers in place are low: financial conditions tighten, liquidity does not feed through to the real economy, the labour market deteriorates further
- Economic crisis evolves into a financial crisis forcing policymakers to move even more in uncharted territory (nationalisations? negative rates? helicopter money? etc.)
- Protectionism and deglobalisation accelerate, negatively affecting trade and global value chains.
- Global potential growth is seriously weakened and pockets of inflation emerge.

Market implications

- Favour cash and US Treasuries
- Favour gold, CHF, Yen
- Play minimum volatility strategies

CENTRAL SCENARIO 65%

Multi-year and multi-speed recovery

Analysis

- Multi-year process to get the world back to order
- 2021 may see a sequence of economic relapses/infections outbreak/selective lockdowns/ policy boosters (our working assumption is that vaccines/ treatments won't be available before H2 2021). Don't rule out a short-lived double dip (Q4)
- Low growth, low inflation, low rates: "unconventional" monetary policies to persist to cope with rising debts. Strong political commitment to mobilise fiscal policies in AEs, but execution is a material risk.
- Global trade to global GDP ratio expected to slip further.
- The Covid crisis exacerbates income and wealth inequalities (risk of increased social tensions)

Market implications

- Contained steepening of US yield curve
- Progressive rotation from credit HY into equity
- Maintain income pockets: EM bond, IG
- Equity thematic are sector and more domestic driven
- Favour gold on pervasive uncertainty, deflation and recession fears

UPSIDE SCENARIO 10%

V-shaped recovery

Analysis

- Rapid development and wide distribution of safe, effective vaccine/ treatments. New outbreaks are avoided.
- Productivity boosts on new digital /green developments or faster normalisation of recovery. With lower uncertainty, policy boosters feed through to the real economy and financial markets, closing gap between manufacturing and service sectors.
- Sustainable recovery and diminishing need for further (fiscal) policy support

Market implications

- US curves steepens (in particular on the long end) on economic recovery and inflation expectations
- Favour risky assets
- Favour linkers, gold as inflation hedge

Covid-19 update

THE DISEASE: new global hotspots emerging

- The Covid-19 death toll is accelerating again amid a remarkable resurgence of infections. At the time of this writing, India's fatalities are on the rise, while Central and South America are the current epicentre of the pandemic. Renewed global hotspots are affecting the Netherlands, Spain, France, Austria and the UK, with caseloads reaching new highs (partly explained by the ramp-up in testing activity). Several states are imposing curfews and seem reluctant to impose lockdowns. Ireland is back to a full lockdown except schools. Near-term downside risks for euro area PMIs and European equities are increasing.

THE SOLUTIONS: advances in testing and treatments continue on a bumpy road

- Medical solutions are tracked on the basis of: (1) diagnostic testing; (2) antibodies therapy and (3) vaccine.
  1. A new PCR-based saliva test (Nine) is available and available on the US market.
  2. Some progress occurred with a new cocktail based on two separate antibodies (Regeneron). Response has been strong in particular in patients given the medicine early in the disease progression.
  3. Pfizer/BioNtech expect efficacy results by the end of October. Recently, J&J paused any further dosing in its phase 3 trial, due to an unexpected illness in a study participant. The timeline still points to 2H21.

TOP RISKS

Monthly update

Risks are clustered to ease the detection of hedging strategies, but they are obviously linked. We maintain the overall narrative and probabilities on the risk outlook with the pandemic exacerbating existing fragilities and vulnerabilities.

ECONOMIC RISK 20%

- **A double-dip recession is a distinct possibility in several countries**
  - Although our ability to deal with the virus has improved (treatment, health infrastructure, and social distancing), the 2nd wave and partial lockdowns may trigger a W-shaped recovery: after a technical rebound (Q3), the global economy is set to slow markedly in Q4 2020, with growth possibly falling in negative territory.
  - While all policy efforts and social benefits have been/will be activated to preserve personal income, the deterioration of the labour market might still weigh on the recovery looking ahead
- **Disinflation in the short run / upward inflationary pressure in the medium term**
  - QE programmes (which will likely be extended) may become problematic during a recovery when inflation enters the equation. The risk is very low in the short run but upward pressure are expected to build over time, as the epidemic fades away.
  - The Fed is moving to average inflation target and the ECB is considering moving in the same direction (among other options)
  - Inflation dynamics and the CB reaction function could be sources of uncertainty. In particular, EM inflation is at an inflection point but the trend ahead remains comfortable due to depressed demand (watch Turkey, India and Mexico)

+ **Cash, linkers, JPY, Gold, USD, Defensives vs. Cyclicals**

- **Oil, risky assets, AUD CAD or NZD, EM local CCY exporters**

FINANCIAL RISK 20%

- **Mounting corporate vulnerability**
  - Prior to the Covid-19 crisis, corporate leverage reached levels above pre-GFC highs
  - The magnitude of the recession will increase solvency risks regardless of central banks' actions and government guarantee schemes
  - Default rates could rise to 15% or even 20% with spillover into the credit market and stress on banks' balance sheets
- **Sovereign debt crisis**
  - Public debt will rise as a share of GDP across most countries in the coming years, starting from already high levels in Europe, Japan and the United States. This could lead to rating downgrades and rising interest rates over the long term
  - Emerging market fragilities (single commodity exporters, tourism), could also face a balance of payment crisis and increase default risks
  - Risks incurred in implementing the European Recovery Fund should not be underestimated. Dissensions among EU members could bring back EZ periphery bond risk

+ **CHF, JPY, Gold, CDS, optionality, Min Vol**

- **Oil, risky assets, frontier markets and EM**

(GEO)POLITICAL RISK 20%

- **Contested US elections**
  - The post voting process is already under scrutiny and the outcome won't be clear on Election Day.
  - A legal dispute over the results could drag on for weeks
  - Although it's unlikely there won't be a President for Inauguration Day, the political uncertainty could climax end November early December
- **US / China tensions**
  - The equally hawkish tone from Democratic Party brings new policy uncertainties to the bilateral relationship in a Biden-win scenario.
  - Possible accidental confrontations in the South China Sea or the Taiwan Strait
- **Hard Brexit**
  - A no-deal Brexit in the context of partial lockdowns could push the UK in a deep recession with spillover effects on the EU.
  - With or without deal, the UK will be outside the EU in 2021, and a phase of adjustment to the new framework will begin. As the UK will try to get trade deals outside the Single Market with potentially better terms, it could create tensions between EU members with similar economic priorities
- **Instability within and among EM countries**

+ **DM Govies, cash, gold, linkers, USD, volatility, quality**

- **Oil, risky assets, EMBI**

CROSS ASSET DISPATCH: Detecting markets turning points

How to the read turning point assessment

Not reached yet too early to call it | Approaching to the turnaround | Turnaround happened

ECONOMIC BACKDROP

- The recovery in economic activity The recovery in economic activity continued in October, despite slowing down significantly as affected by the new surge of Covid-19 cases across the globe.
- The softening momentum is further highlighted by the Citi Economic Surprise Index, which continues its downward reversion both in the EZ and in the US.
- Soft and hard data confirm the softening trend and sector divergence, with manufacturing sector holding up better than services.
- Yet, increasingly stricter mobility restrictions increase the risk of a contraction in activity the fourth quarter.

FUNDAMENTALS & VALUATION

- **Risky assets look less expensive as EPS start to gradually recover.**
- Equities' absolute PEs are still higher than their historical average even considering high 2021 EPS expectations. The equity risk premium and PE adjusted for CB liquidity injections favour equities in terms of relative value.
- So far, CBs have prevented any significant market correction since April, providing strong support to risky assets.

DEFENSIVE ASSET ALLOCATION

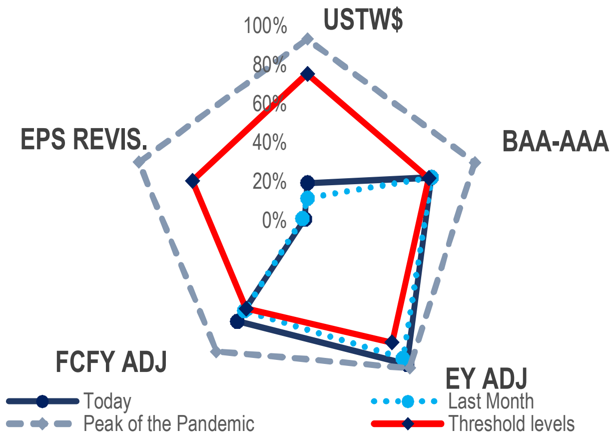
TECHNICALS

- Technical signals have strongly supported the first leg of the rebound in risky assets since March.
- Momentum, the strongest market mover since the summer, turned out less supportive this month. Seasonality, US election risk and a potential second round of restrictions have weighed on risky assets since the beginning of September.
- From a contrarian standpoint, markets are not overstretched any more though, as the recent sell-off has normalised the picture.
- Technicals remain thus overall neutral, as trend following signals and contrarian indicators compensate each other

SENTIMENT

- CAST remains the strongest contributor. EPS revisions have rebounded, and the USD depreciation has added support. The credit risk premium (Moody's BAA-AAA) remains around the alert threshold, but it's not enough to offset the call.
- Financial conditions eased further over the summer, as central banks pushed appetite for spreads products higher.
- Cross asset flows (based on State Street data) confirm the mild pro-risk stance. Although appetite for high beta and cyclical segments moved lower in September, the overall flows scorecard remain in neutral+ territory.

Cross Asset Sentinels Thresholds (CAST) still supportive



Amundi Research, Data as of 26 October 2020

CAST flags extremely low risk perception.

Sentinels remain in pro risk territory due to a general improvement in all the components (except ERP adjusted for credit risk).

<u>Methodology</u> We consider five inputs which we call "Sentinels": USTW$, Moody's Baa-Aaa, EPS revisions, Earning Yield risk adjusted and Cash Flow yield risk adjusted. These sentinels are used to reposition our tactical asset allocation. Once sound thresholds are detected, the five variables are aggregated as an indicator that anticipates the market's stress conditions, with a certain level of conviction. The pentagon visualizes the five sentinels where the red line represents the alert threshold. The greater the distance above the red line, the higher the risk perception, and eventually the need to move closer to a defensive asset allocation.

GLOBAL RESEARCH CLIPS

1 Adjusting our central scenario to the impact of the 2nd wave

- The Covid-19 2nd wave is much stronger than expected in many European countries while the situation has also recently deteriorated in the US. Latin America has become the epicentre of the pandemic.
- Authorities have to choose between public health i.e. lockdowns and economic wealth. In Europe, the priority is clearly to maintain public health.
- Despite medical advances and treatments, we are still in the grip of Covid-19 a year after it appeared in China and a vaccine is still not available.
- This changes the balance of risk in our scenario analysis. We increase the probability of the downside scenario from 20 to 25% (deep recession/ secular stagnation) and reduce the central scenario probability to 65%.

2 Q4 GDP growth may return in negative territory

- After the technical rebound, the global recovery is confirmed smoother. We expect weaker growth both in the US and in Europe. We do not rule out a mild double dip in our central scenario.
- High frequency indicators in aggregate show a flattening curve.
- The service sector continues to suffer with increasing divergences with manufacturing. Tourism, leisure and consumer-facing activities remain highly disrupted. The situation will mechanically deteriorate further in economies subject to new restrictions.

3 Emergency measures are back, with the blessing of CBs

- Emergency measures are back. The second wave will once again increase the pressure on policymakers to act. The major central banks (notably the Fed and ECB) are calling on governments to do more. This means that CBs will (when possible) continue to support their efforts, by increasing their asset purchase programmes.
- This postpones until a little later the need to implement stimulus plans (infrastructures in the US, Recovery fund in Europe).
- Execution of structural/medium term oriented /fiscal measures remain however key. In Europe, the EU recovery plan is in the national approbation phase which might be longer than expected. 4 years after the referendum, the uncertainty on the Brexit outcome remains.
- Bad news is no longer good news. The policy mix, however proactive it may be, is not able to offset all the effects of the Covid crisis.

4 The ECB inflation challenge

- What if the risk of deflation intensifies and the euro appreciates further? This could be a dangerous cocktail for the ECB.
- A rate cut is the only effective tool that the ECB has at its disposal to combat deflationary pressure exacerbated by the euro appreciation but it would have negative side effects hosted my some members in the Council.
- Negative deposit rate and yields could weaken the euro and alleviate the burden of sovereign debt. But are a tax on the banking system despite rates tiering and may not stimulate economy with positive `reversal rate while it could endanger financial stability and remain difficult to exit. ‘
- The bar is high to cut rates (outright deflationary pressure coupled with a strong appreciation of the euro). We expect the ECB to extend its QE, in time and in volume.

The impact of the Covid-19 crisis on global social and economic inequalities

The extraordinary economic growth and social progress seen since WW2 have been underpinned by increasing wealth and income divergence across the globe, in particular in emerging economies and the United States. The steep Covid-19-driven economic recession is likely to further widen inequalities due to the combined effects of several factors. The business sectors most severely affected by the lockdown measures are those employing the highest percentage of low-income, low-education and low-saving workers, who are clearly the most exposed to sudden income changes. Similarly, the impact on young people and women is particularly severe, increasing gender and social inequalities. Despite already evident signs, the magnitude of the economic and social impact of the pandemic is extremely dependent on its length and the efforts made by governments and international authorities to counterbalance it. The extensive reliance on debt financing to fund social, welfare and labour protection schemes is driving countries' debt burdens to historical highs, raising questions as to their sustainability, and potentially forcing governments to progressively revert to a more disciplined fiscal approach going forward. Similarly, potential pandemic-driven structural changes such as the shortening of supply chains across the globe could further accelerate inequalities in emerging economies, and also lead to significant disruptions across the developed markets. If there is uneven access to a new Covid-19 vaccine, this could be a key catalyst causing wider inequalities and leading to a multi-stage global economic recovery.

AMUNDI ASSET CLASS VIEWS

	Asset Class	View	1M change	Rationale
EQUITY PLATFORM	US	-/=		Equity risk premia are attractive relative to bonds, but this doesn't mean there cannot be volatility, particularly with respect to the election outcomes. However, expectations of continued recovery, improving earnings forecasts, and a low possibility of an all-encompassing national lockdown should support prices, particularly for the cyclical and quality components of the market. Overall, investors should play market divergences with a balanced stance.
EQUITY PLATFORM	Europe	=		The economy is improving, but resurgence of virus cases and subsequent lockdowns in the region may make the recovery bumpy. The result is extreme market dispersions, which are creating opportunities for active stock pickers. We look for names with strong balance sheets and resilient business models.
EQUITY PLATFORM	Japan	=		Pro-cyclical markets such as Japan should be supported by global growth prospects and attractive valuations. However, investors should stay watchful and balanced till when there is more visibility on the growth path.
EQUITY PLATFORM	Emerging markets	=		Improving economic prospects should support EM assets in 2021, but geopolitical risks, such as the recent sanctions on Russia and US elections, coupled with the US-China rivalry for global dominance, are key variables. Nonetheless, the crisis has reinforced China's role as the global growth engine, and Asian and other economies exposed to this will benefit. With an overall neutral stance, we like the semiconductor sector and attractively valued growth names.
FIXED INCOME PLATFORM	US govies	=	▼	We stay neutral/slightly positive on US duration in our global portfolios in light of UST characteristics to provide a safeguard against an uncertain economic environment. In US portfolios, we see long-term inflation prospects and prefer TIPS to UST.
FIXED INCOME PLATFORM	US IG Corporate	=/+		The IG segment will continue to find support in monetary stimulus from the Fed, though political uncertainty may cause volatility. Investors should stay active and pare back spread duration where risks are asymmetric. We selectively like consumer and residential mortgages, given the strong consumer and housing markets.
FIXED INCOME PLATFORM	US HY Corporate	-/=		We remain cautious on HY, particularly where downside potential is higher than the potential for gains. While the market will be supported by CB action, the case for selectivity is high, given that some businesses will be unable to withstand a slow recovery.
FIXED INCOME PLATFORM	European govies	-/=		We are cautious on this space as rates are already at low levels, but remain active, with a focus on relative value trades. However, on peripheral debt, we stay positive amid continued ECB support and reducing fragmentation and political risks (particularly in Italy).
FIXED INCOME PLATFORM	Euro IG Corporate	+	▼	We believe IG spreads have tightened and there is little juice left to squeeze in this asset class, although ECB QE should provide support. We continue to prefer EUR over US, due to lower leverage in the latter, and play this through financial and subordinated debt that offer the potential of that extra yield. Overall, we maintain high focus on selection and liquidity.
FIXED INCOME PLATFORM	Euro HY Corporate	=		We recommend investors balance the need for high income with the requirement of buying quality credit at attractive prices. It is important to note that the current abundant liquidity is inflating the price of credit even for companies which will witness a deterioration of performance. So, the need for selection and cash buffers is very high.
FIXED INCOME PLATFORM	EM Bonds HC	=/+		We stay positive on HC debt, but believe there is a need for caution over the outcome of US elections and the inability of central banks in some EM to finance the governments' fiscal deficits. Investors should selectively lock in gains in IG, but, we think, there is some value left in HY names where spreads are still wide.
FIXED INCOME PLATFORM	EM Bonds LC	=		We are cautious and realise that prospects of higher rates in the US (whenever that happens) could be slightly negative for EM rates. Consequently, we stay vigilant, maintain a dynamic stance to capture any dislocations, and believe investors should book profits where upside is limited.
OTHER	Commodities			The Saudi-led supply cuts have helped clear the oversupply imbalance in the oil market. On metals, the recent sell-off in gold (and silver) is related to the concerns of higher real rates, "normal" risk-on, and a pause in asset buying by the Fed. CBs' monetary policies have been the strongest driver of gold prices and as long as they maintain this extra dovish stance any painful sell-off seems unlikely going forward. In contrast, should CBs unexpectedly change their policies, gold may be vulnerable to a serious derating, as the metal's fair value, based on traditional metrics (rates and FX), is far lower than current levels. All in all, commodities are benefiting from liquidity injections by CBs, USD and a strong CNY.
OTHER	Currencies			Given that the US has lost its economic growth and rates advantage vs the rest of the G10 countries, the USD could see a correction vis-à-vis G10 FX, provided growth revisions do not occur. If, however, UK and EZ growth disappoint, then the movement will be less pronounced. Interestingly, FX correlation with risk sentiment is elevated, as evident in September when the USD proved resilient. Therefore, there is a possibility that with the political uncertainty in the US and rising volatility, the mean reversion of the USD to its fair value may be limited. On the other hand, GBP movements will be closely linked to news flow around Brexit.

LEGEND

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	Negative		Neutral		Positive		Downgrade vs previous month	Upgraded vs previous month

Source: Amundi 4 November 2020, views relative to a EUR-based investor. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research, investment advice or a recommendation regarding any fund or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. This information does not represent the actual current, past or future asset allocation or portfolio of any Amundi product. IG = Investment grade corporate bonds, HY = High yield corporate; EM bonds HC/LC = EM bonds hard currency/local currency. WTI = West Texas Intermediate. QE = Quantitative easing.

DEVELOPED COUNTRIES

Macroeconomic outlook

Data as of 27/10/2020

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
World	**3.0**	**-4.5/-3.8**	**5.1;5.8**	**3.1**	**2.6**	**2.7**
Developed countries	**1.7**	**-6.2/-5.7**	**4.5;5.1**	**1.5**	**0.7**	**1.4**
US	**2.3**	**-4.6/-4.0**	**4.3;4.9**	**1.8**	**1.2**	**2.1**
Japan	**1.2**	**-5.1/-4.5**	**2.9;3.5**	**0.7**	**0.0**	**0.2**
UK	**1.4**	**-11.5/-10.5**	**7.0;9.0**	**1.8**	**0.8**	**1.5**
Eurozone	**1.2**	**-8.1/-7.5**	**5.0;5.6**	**1.2**	**0.3**	**1.0**
Germany	0.6	-6.3/-5.7	3.1;3.7	1.5	0.6	1.3
France	1.2	-10.0/-9.4	6.3;6.9	1.3	0.6	1.1
Italy	0.3	-10.0/-9.4	4.7;5.3	0.7	-0.2	0.6
Spain	2.0	-12.4/-11.7	5.9;6.5	0.7	-0.3	0.8

Source: Amundi Research

- **United States:** the US economy rebounded in Q3, exceeding our expectations and leading to a further upside revision of our 2020 GDP forecasts. However, given the signs of a progressive deceleration in several economic and behavioural indicators, influenced by the new rise in Covid-19 cases, we are more cautious about the speed at which the economy will enter 2021. After some softening in H2 2020, headline inflation should move higher, with a temporary mid-year overshoot due to reversing oil price base effects. It will then revert to the target. As November 3 approaches, policymakers' focus is shifting, with an increased risk that 2020 fiscal policy will become more diluted than expected, and with little visibility on the Phase 4 deal in particular.
- **Eurozone:** after the strong rebound in early Q3, we have revised our forecasts for 2020 slightly upwards. However, the recovery curve for the Eurozone economies has flattened significantly, affected by the second wave of Covid-19, aggravating concerns of a potential slowdown in economic activity in Q4. We expect a progressive pickup in both domestic and external demand, supported by an extraordinary easing of monetary policy and counter-cyclical fiscal policies. Inflation should remain subdued in the near term with possible downside risks before moving gradually higher in 2021, yet remaining somewhat below target. Temporary extensions of furlough schemes are preventing severe distress in the labour market, although we expect the unemployment rate to continue increasing in early 2021.
- **Japan:** the latest data confirmed our view of a slow economic recovery. The second wave of Covid-19 cast a shadow over consumption and business sentiment, while mobility and domestic tourism were less hit than in April, thanks to the government's Go To Travel scheme and less stringent restriction measures. External demand started to bottom out, but Japanese export recovery lags behind its East Asian peers. Overall, we expect investments to bounce back at a slower pace than exports and consumption, and forecast GDP remaining below pre-pandemic levels until 2022.
- **United Kingdom:** the economy grew at a sustained pace during the summer, technically rebounding from the Q2 dip. The Covid-19 resurgence and new restrictions being implemented nationwide led to a significant deceleration in economic activity from September and rising concerns of a rapid deceleration in Q4. The labour market remains under pressure, despite the new job support schemes introduced to replace the previous furlough schemes. A new round of fiscal support is more likely, together with some easing on the monetary front later in the year with additional Brexit downside risk looming as negotiations stall.

Key interest rate outlook

	28-10 2020	Amundi + 6m.	Consensus Q2 2021	Amundi + 12m.	Consensus Q4 2021
US	**0.13**	**0/0.25**	**0.08**	**0/0.25**	**0.07**
Eurozone	**-0.50**	**-0.50**	**-0.54**	**-0.50**	**-0.60**
Japan	**-0.05**	**-0.1**	**-0.06**	**-0.1**	**-0.09**
UK	**0.10**	**0.00**	**0.04**	**0.00**	**-0.04**

Source: Amundi Research

- **Fed:** The Fed unveiled its new forward guidance associated with the recent changes to its longer-run goals and monetary policy strategy. The current rate will be maintained "until labour market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time". The new economic projections show that rates will stay at zero at least through to the end of 2023. The Fed made no changes to the asset purchase programme and showed no urgency in transitioning to a more traditional QE that tilts purchases toward longer maturities. The QE will remain at the current pace "over the coming months".
- **ECB:** In September, the pace of ECB purchases failed to return to July levels, with technical factors and the market environment supportive to Euro government bonds. The central bank is likely to increase the weight of its currently limited purchases of supras given the size of forthcoming EU issuance. A broad consensus expects the ECB to increase the size and extend the horizon of its QE programme into the second half of next year. The downside risks to the macro outlook and the upside risks to next year's sovereign financing needs due to the recent pandemic trends, together with low inflation expectations support this eventual move before the end of the year.
- **BoJ:** We expect the central bank to continue its accommodative policy stance into 2021, in the form of asset purchasing, YCC and a special funding programme for SMEs. Meanwhile, Suga's Cabinet has hinted at a third supplementary budget for FY2020 (due early next year), and an expansive fiscal stance for FY2021. This reduces the odds on the BoJ adding stimulus measures, despite a soft economic recovery. In the risk scenario of a fresh, deadly pandemic outbreak, a combination of strengthened forward guidance and increased special funding is more likely in our view.
- **BoE:** As broadly expected, the Bank of England left its policy rates unchanged. It also acknowledged the risks to future economic growth posed by the recent pandemic trends and by the Brexit outcome. The BoE is still expected to extend its QE before the year-end, when the current programme is scheduled to end. In the short-term, the QE policy package and the forward guidance are likely to remain as preferred rather than the introduction of new tools, despite the recent decision to explore the negative rates option in the future.

Monetary policy agenda

Central banks	Next meeting
Federal Reserve FOMC	**November 4**
ECB Governing Council	**December 10**
Bank of Japan MPM	**December 18**
Bank of England MPC	**November 5**

Source: Amundi Research

EMERGING COUNTRIES

Macroeconomic outlook

Data as of 27/10/2020

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
World	3.0	-4.5/-3.8	5.1;5.8	3.1	2.6	2.7
Emerging countries	3.9	-3.3/-2.5	5.5;6.3	4.3	3.9	3.6
Brazil	1.1	-4.9/-4.4	3.4;4.4	3.7	3.0	3.4
Mexico	-0.3	-8.8/-8.3	3.8;4.8	3.6	3.5	3.3
Russia	1.3	-4.0/-3.7	2.5;4.0	4.5	3.2	3.75
India	4.9	-9.3/-8.3	7.0;8.2	3.7	6.6	6.1
Indonesia	5.0	-3.4/-2.8	2.8;3.6	2.8	2.1	2.9
China	6.2	-1.5/-2.1	7.9;8.5	2.9	2.6	1.8
South Africa	0.2	-9.1/-8.1	1.9;2.9	4.1	3.1	3.8
Turkey	0.8	-5.2/-4.2	4.0;5.0	15.5	11.5	11.0

Source: Amundi Research

- **China:** after the initial v-shaped rebound, economic recovery slowed sequentially in Q3,increasingly driven by the private sector. Consumption made a larger contribution to growth than investments, following a further normalisation of services activities. As policy tilted towards neutral, state-led stimulus started to ease, with infrastructure investments slowing for the third consecutive month in September. In light of this policy adjustment, we expect the Chinese economy to recover at a slower but more sustained pace.
- **Brazil:** Brazil lead the regional race from the bottom with growth continuing to expand robustly driven by normalising mobility and an aggressive policy response - GDP will still contract by around 4.5% in 2020. Going forward, the economy will have to digest 8% of GDP as part of the unwinding of fiscal stimulus if the spending cap is fully complied with. A better outcome would be a trade-off of a temporary cap circumvention for fiscal reform and a more sustainable fiscal story – something we believe the markets and the BCB would be happy with. It would also allow the administration to shift the focus to its reform agenda.
- **Turkey:** the CBRT surprised the markets again by only increasing its Late Liquidity Window Lending Rate. According to the press release, the decision was motivated by three positive developments: a normalisation of commercial and consumer loans, an improvement in the current account, and previous tightening which was significant enough to anchor inflation expectations. The CBRT will likely continue to tighten monetary conditions solely through liquidity measures, focusing on increasing the Average Cost of Funding which is now at 12.5% and could theoretically rise to 14.75% by the end of the year.
- **South Africa:** after a sharp contraction of real GDP in Q2 (-17%yoy), high frequency indicators rebounded in Q3. Nevertheless, most sectors remain below pre-crisis levels and uncertainties surrounding the pandemic remain high. Risks are skewed to the downside. Even though inflation is expected to remain subdued, the SARB is restricted because of fiscal deterioration. Indeed, the budget deficit is expected to widen to more than 15% of GDP this year and debt sustainability is at risk. However, if the economic situation worsens, we cannot rule out another cut by the SARB.

Key interest rate outlook

	26-10 2020	Amundi + 6m.	Consensus Q2 2021	Amundi + 12m.	Consensus Q4 2021
China	3.85	3.85	3.8	3.85	3.8
India	4	4	3.7	4	3.7
Brazil	2	2	2	2	2.4
Russia	4.25	4.00	4.15	4.25	4.35

Source: Amundi Research

Monetary policy agenda

Central banks	Next communication
PBoC	**November 20**
RBI	**December 4**
BCB Brazil	**November 4**
CBR	**November 2**

Source: Amundi Research

- **PBoC (China):** the Loan Prime Rate (LPR) remained unchanged for the sixth consecutive month in October, as we had expected. On 21 October, Governor Yi said he expected China's macro leverage ratio to stabilise in 2021, after rising by 21ppt to 266% at the end of H1 2020 from end-2019 to mitigate the damage caused by the pandemic. The latest focus by policymakers on balancing growth and risk prevention signals a shift away from a loose regulatory environment. In light of this policy adjustment, we expect total social financing growth – the proxy for credit impulse – to stabilise and peak.
- **RBI (India):** in its latest meeting, the RBI left its policy rates unchanged, as expected. The appointment of three new members (aimed at increasing the RBI's dovish bias) did not bring any change in policy rate levels while a major dovish tilt was anticipated by the Governor in the form of possibly stronger QE going forward. Should the RBI adopt less orthodox monetary policy measures, a stronger fiscal strategy would need to be in place in coordination with the Ministry of Finance. A dovish stance was confirmed though inflation should offer little room for easing in the short term (0/-25bps).
- **BCB (Brazil):** The easing cycle ended in September when the BCB stayed on hold at 2% and removed references to further easing (any leeway being limited) in the QIR. The focus has since shifted to forward guidance (FG) - rates are to stay on hold until inflation gets sufficiently close to the target. The FG, however, is also a function of spending cap (SC) compliance and will be unwound if the latter is breached - the CB will not tolerate inflationary risks emanating from the markets and raising questions as to the country's fiscal credibility. We think a temporary SC breach for fiscal reform would satisfy the markets and the BCB, and also give growth some necessary support.
- **CBR (Russia):** The CBR left the policy rate unchanged at 4,25% at the October 23rd meeting, as was the case on September 18th. The CBR mentioned a set of factors impacting inflation in different directions, including an increase in inflation expectations, a slowdown in the economic recovery, increased market volatility and its potential negative impact on the rouble. The CBR expects inflation to end up very near the target of 4% at year-end. Nonetheless, the central bank still sees room for a rate cut especially in the medium-term due to disinflationary risks.

MACRO AND MARKET FORECASTS

Macroeconomic forecasts
(27 October 2020)

Annual averages (%)	Real GDP growth %			Inflation (CPI, yoy, %)		
	2019	2020 range	2021	2019	2020	2021
US	2.3	-4.6/-4.0	4.3/4.9	1.8	1.2	2.1
Japan	1.2	-5.1/-4.5	2.9/3.5	0.7	0.0	0.2
Eurozone	1.2	-8.1/-7.5	5.0/5.6	1.2	0.3	1.0
Germany	0.6	-6.3/-5.7	3.1/3.7	1.5	0.6	1.3
France	1.2	-10.0/-9.4	6.3/6.9	1.3	0.6	1.1
Italy	0.3	-10.0/-9.4	4.7/5.3	0.7	-0.2	0.6
Spain	2.0	-12.4/-11.7	5.9/6.5	0.7	-0.3	0.8
UK	1.4	-11.5/-10.5	7.0/9.0	1.8	0.8	1.5
Brazil	1.1	-4.9/-4.4	3.4/4.4	3.7	3.0	3.4
Mexico	-0.3	-8.8/-8.3	3.8/4.8	3.6	3.5	3.3
Russia	1.3	-4.0/-3.7	2.5/4.0	4.5	3.2	3.75
India	4.9	-9.3/-8.3	7.0/8.2	3.7	6.6	6.1
Indonesia	5.0	-3.4/-2.8	2.8/3.6	2.8	2.1	2.9
China	6.2	1.5/2.1	7.9/8.5	2.9	2.6	1.8
South Africa	0.2	-9.1/-8.1	1.9/2.9	4.1	3.1	3.8
Turkey	0.8	-5.2/-4.2	4.0/5.0	15.5	11.5	11.0
Developed countries	1.7	-6.2/-5.7	4.5/5.1	1.5	0.7	1.4
Emerging countries	3.9	-3.3/-2.5	5.5/6.3	4.3	3.9	3.6
World	3.0	-4.5/-3.8	5.1/5.8	3.1	2.6	2.7

Key interest rate outlook

Developed countries

	28/10/2020	Amundi + 6m.	Consensus Q2 2021	Amundi + 12m.	Consensus Q4 2021
US	0.13	0/0.25	0.08	0/0.25	0.07
Eurozone	-0.50	-0.50	-0.54	-0.50	-0.60
Japan	-0.05	-0.1	-0.06	-0.1	-0.09
UK	0.10	0.00	0.04	0.00	-0.04

Emerging countries

	26/10/2020	Amundi + 6m.	Consensus Q2 2021	Amundi + 12m.	Consensus Q4 2021
China	3.85	3.85	3.8	3.85	3.8
India	4	4	3.7	4	3.7
Brazil	2	2	2	2	2.4
Russia	4.25	4.00	4.15	4.25	4.35

Long rate outlook

2Y. Bond yield

	28/10/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	0.15	0.10/0.3	0.18	0.1/0.3	0.21
Germany	-0.787	-0.70/-0.50	-0.84	-0.70/-0.50	-0.89
Japan	-0.12	-0.20/-0.10	-0.13	-0.20/-0.10	-0.12
UK	-0.052	0/0.25	-0.11	0/0.25	-0.13

10Y. Bond yield

	28/10/2020	Amundi + 6m.	Forward + 6m.	Amundi + 12m.	Forward + 12m.
US	0.77	0.7/0.9	0.87	0.9/1.1	0.96
Germany	-0.62	-0.60/-0.40	-0.58	-0.50/-0.30	-0.55
Japan	0.03	-0.10/0.10	0.07	0/0.2	0.11
UK	0.22	0.20/0.4	0.30	0.3/0.5	0.36

Currency outlook

	23/10/2020	Amundi Q2 2021	Consensus Q2 2021	Amundi Q4 2021	Consensus Q4 2021
EUR/USD	1.186	1.195	1.20	1.21	1.22
USD/JPY	105	104	105	106	105
EUR/GBP	0.91	0.91	0.90	0.90	0.90
EUR/CHF	1.07	1.09	1.09	1.12	1.11
EUR/NOK	10.96	10.44	10.40	10.30	10.20

	23/10/2020	Amundi Q2 2021	Consensus Q2 2021	Amundi Q4 2021	Consensus Q4 2021
EUR/SEK	10.38	10.25	10.30	9.99	10.23
USD/CAD	1.31	1.30	1.30	1.28	1.29
AUD/USD	0.71	0.74	0.73	0.76	0.75
NZD/USD	0.67	0.67	0.68	0.68	0.70
USD/CNY	6.69	6.55	6.75	6.40	6.75

Source: Amundi Research

DISCLAIMER TO OUR FORECASTS

The uncertainty around the macro forecasts is very high, and it triggers frequent reassessments any time fresh high frequency data are available. Our macroeconomic forecasts at this point include a higher qualitative component, reducing the statistical accuracy and increasing the uncertainty through wider ranges around them.

METHODOLOGY

– **Scenarios**

The probabilities reflect the likelihood of financial regimes (central, downside and upside scenario) which are conditioned and defined by our macro-financial forecasts.

– **Risks**

The probabilities of risks are the outcome of an internal survey. Risks to monitor are clustered in three categories: Economic, Financial and (Geo)politics. While the three categories are interconnected, they have specific epicentres related to their three drivers. The weights (percentages) are the composition of highest impact scenarios derived by the quarterly survey run on the investment floor.

PUBLICATIONS HIGHLIGHTS

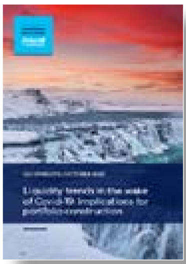
THE DAY AFTER

The day after #12
Changing shares of labour and capital incomes: what implications for investors? (21-10-2020)
BARBERIS Jean-Jacques, Head of Institutional and Corporate Clients Coverage - BLANCHET Pierre, Head of Investment Intelligence - POUGET-ABADIE Théophile, Business Solutions and Innovation

The day after #11
Post-crisis narratives that will drive financial markets (23-09-2020)
BLANQUE Pascal, Group Chief Investment Officer

The day after #10
Rethinking the macro and cross-asset research: what we have learned from the Covid-19 crisis (20-07-2020)
DEFEND Monica, Global Head of Research

INSIGHTS PAPERS



Liquidity trends in the wake of Covid-19: implications for portfolio construction (28-10-2020)
BLANQUE Pascal, Group Chief Investment Officer - MORTIER Vincent, Deputy CIO, Asia ex Japan Supervisor - GUIGNARD Matthieu, Global Head of Product Development & Capital Markets - ETF, Indexing & Smart Beta - MINIERI Gianluca, CEO of Amundi Intermediation UK and Ireland

Emerging markets charts & views - market opportunities looking into 2021 (13-10-2020)
SYZDYKOV Yerlan, Global Head of EM

Building ESG momentum in US equities (13-10-2020)
STERLING Craig, Head of Equity Research, US Director of Core Equity, Portfolio Manager

Risk budgeting and trade sizing: why they matter to multi-asset portfolio construction (21-09-2020)
GERMANO Matteo, Head of Multi-Asset — MCDONALD Shane, Head of Multi Asset Portfolio Construction and Financial Engineering — ORTISI Matteo, Portfolio Construction and Financial Engineering_Senior Analyst — TAZÉ-BERNARD Eric, Chief Allocation Advisor

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INVESTMENT TALKS

Election countdown: A Trump opening after the final Presidential debate? (27-10-2020)
UPADHYAYA Paresh, Director of Currency Strategy, US Portfolio Manager, US

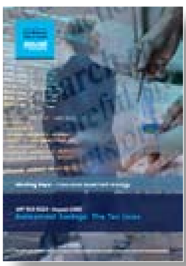
Time to reconsider US growth and value? (21-10-2020)
PIRONDINI Marco, Head of Equities, US Portfolio Manager — MURRAY Alec, Client Portfolio Manager – Equities

A civil vice presidential debate has little impact on the race (09-10-2020)
UPADHYAYA Paresh, Director of Currency Strategy, US Portfolio Manager, US

President Trump's positive COVID-19 test shakes up election, markets (05-10-2020)
UPADHYAYA Paresh, Director of Currency Strategy, US Portfolio Manager, US

Advantage Biden after the first Presidential Debate (01-10-2020)
UPADHYAYA Paresh, Director of Currency Strategy, US Portfolio Manager, US

WORKING PAPERS



Retirement savings: the tax issue (15-09-2020)
MAILLARD Didier, Professor - Conservatoire National des Arts et Métiers, Senior Advisor, Amundi

Climate change investment framework (09-09-2020)
AIIB, Asian Infrastructure Investment Bank — Amundi Research

Measuring and managing carbon risk in investment portfolios (2020-08)
RONCALLI Theo , LE GUENEDAL Theo, LEPETIT Fréderic, SEKINE Takaya, Quantitative Research — RONCALLI Thierry, Head of Quantitative Research

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